Oak Valley Bancorp
Form 10-K
March 30, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2015

OR

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

OAK VALLEY BANCORP

(Exact name of registrant as specified in its charter)

California	**26-2326676**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
125 North Third Avenue Oakdale, California	**95361**
(Address of principal executive offices)	(Zip Code)

(209) 848-2265

(Registrant's telephone number including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock	The NASDAQ Stock Market, LLC

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of class)

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

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange 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 requirements 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

Yes No

As of December 31, 2015, the aggregate market value of the registrant’s common stock held by non-affiliates of the registrant, based upon the closing price per share of the registrant’s common stock as reported by the NASDAQ, was approximately $69 million. As of March 17, 2016, there were 8,088,155 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s Proxy Statement for the Annual Meeting of Shareholders to be held on June 21, 2016 are incorporated by reference into Part III.

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PART I

ITEM 1. BUSINESS OF OAK VALLEY BANCORP

Overview of the Business

Oak Valley Bancorp. Oak Valley Bancorp (the "Company") was incorporated on April 1, 2008 in California for the purpose of becoming Oak Valley Community Bank's parent bank holding company. Effective July 3, 2008, Oak Valley Bancorp acquired all of the outstanding capital stock of Oak Valley Community Bank (the "Bank") (from time to time, the Bank and the Company may be generally referred to as "we", "us" or "our"). The principal office of Oak Valley Bancorp is located at 125 North Third Avenue, Oakdale, California 95361 and its principal telephone is (209) 848-2265.

The Company is authorized to issue 50,000,000 shares of common stock, without par value, of which 8,078,155 are issued and outstanding at December 31, 2015, and 10,000,000 shares of preferred stock, without par value, of which no shares are issued and outstanding.

The Company is the holding company of the Bank, and its only assets are the outstanding capital stock of the Bank, which the Company wholly owns, cash and income tax benefits receivable classified as other assets.

Oak Valley Community Bank. The Bank commenced operations in May 1991. The Bank is an insured bank under the Federal Deposit Insurance Act and is a member of the Federal Reserve. The Bank is subject to regulation, supervision and regular examination by the California Department of Business Oversight (DBO), the Federal Deposit Insurance Commission (FDIC) and the Federal Reserve Board (FRB). Since its formation, the Bank has provided basic banking services to individuals and business enterprises in Oakdale, California and the surrounding areas. The focus of the Bank is to offer a range of commercial banking services designed for both individuals and small to medium-sized businesses in the two main areas of service of the Bank: the Central Valley and the Eastern Sierras.

The Bank offers a complement of business checking and savings accounts for its business customers. The Bank also offers commercial and real estate loans, as well as lines of credit. Real estate loans are generally of a short-term nature for both residential and commercial lending purposes. Longer-term real estate loans are generally made with adjustable interest rates and contain customary provisions for acceleration. Traditional residential mortgages are available to Bank customers through a third party.

The Bank offers other services for both individuals and businesses including online banking, remote deposit capture, mobile banking, merchant services, night depository, extended hours, wire transfer of funds, note collection, and automated teller machines in a national network. The Bank does not currently offer international banking or trust services although the Bank may make such services available to the Bank's customers through financial institutions with which the Bank has correspondent banking relationships. The Bank does not offer stock transfer services nor does it directly issue credit cards.

On December 23, 2015, the Company completed its acquisition of Mother Lode Bank ("MLB"), a California state-chartered bank headquartered in Sonora, California, in a transaction in which Mother Lode Bank was merged with and into the Bank, with the Bank as the surviving company in the transaction. The purchase price for Mother Lode Bank was approximately $7.3 million. As of the acquisition date, Mother Lode Bank's total assets were $78.7 million and total deposits were $71.1 million.

Expansion

Branch Expansion. Since opening our doors of the main Oakdale branch in 1991, our network of branches and loan production offices have been expanded geographically. As of December 31, 2015, we maintained eighteen full-service branch offices (in addition to our corporate headquarters). Beginning in October 1995, we started our geographic expansion outside of Oakdale, by opening a Loan Production Office in Sonora, California. We subsequently opened a branch in Sonora and two branches in Modesto. In September 2000, we expanded into the Eastern Sierra, opening a branch in Bridgeport, California under the name Eastern Sierra Community Bank. Since that time we have added branches in Mammoth Lakes and Bishop. During 2005 and 2006, we aggressively increased our presence in the Central Valley, by opening branches in Turlock, Stockton, Patterson, Ripon and Escalon. In March 2007, our corporate headquarters expanded by adding an adjacent historical building located in downtown Oakdale to its complex. In 2011, we opened a third branch in Modesto and a branch in Manteca. In 2014, we opened a new branch in Tracy. In 2015, we added a second branch in Sonora. Later in 2015, Mother Lode Bank was merged with and into the Bank, which temporarily added two more branches in Sonora until they were eventually closed in January 2016 decreasing our total number of branches to sixteen, after management determined that our two existing branches would be able to support our new customers. We intend to continue our growth strategy in future years through the opening of additional branches and loan production offices as our needs and resources permit.

Bank Holding Company Reorganization. Effective July 3, 2008, we entered into a bank holding company reorganization, whereby each outstanding share of common stock of the Bank was exchanged into a share of common stock of the Company. Operating our banking business within a holding company structure provides, among other things, greater operating flexibility; facilitates the potential acquisition of related businesses as opportunities may arise from time to time; improves our ability to diversify as needed; enhances our ability to remain competitive in the future with other companies in the financial services industry that are organized in a holding company structure; and improves our ability to raise capital to support growth.

Business Segments

The Bank operates in two primary lines of business: Retail Banking and Commercial Banking, as described in additional detail below. These business lines do not meet the quantitative thresholds for reporting as separate segments and are therefore considered one segment for financial reporting purposes.

Retail Banking. We offer a range of checking and savings accounts, including NOW accounts, money market accounts, overdraft protection, health savings accounts, certificates of deposit, and Individual Retirement Accounts (“IRA”). To satisfy the lending needs of individuals in its service area, we offer real estate and home equity financing, as well as consumer, automobile, and home improvement loans.

Commercial Banking. We offer a range of deposit and lending services to business customers. More specifically, we offer a variety of commercial loans for virtually any business, professional, or agricultural need. These include loans for short-term working capital, operating lines of credit, equipment purchases, leasehold improvements, construction, commercial real estate acquisitions or refinancing. Currently, virtually all of our business relationships are with customers located in the San Joaquin, Stanislaus, Tuolumne, Inyo and Mono Counties, of California.

Primary Market Area

We conduct business from our main office in Oakdale, a city of approximately 21,500 residents located in Stanislaus County, California. Oakdale is approximately 15 miles from Modesto and sits at the foothills of the Sierra Nevada Mountains, at the edge of the California Central Valley agricultural area. Through our branches, we serve customers in the Central Valley, from Fresno to Sacramento, and in foothill locations. We also reach into the Highway 395 corridor in the Eastern Sierras and in the towns of Bishop, Mammoth and Bridgeport. Approximately 87% of our loans and 87% of our deposits are generated from the Central Valley. The Central Valley area includes Stanislaus, San Joaquin and Tuolumne counties and has a total population of over 3 million.

Lending Activities

General. Our loan policies set forth the basic guidelines and procedures by which we conduct our lending operations. These policies address the types of loans available, underwriting and collateral requirements, loan terms, interest rate and yield considerations, compliance with laws and regulations and our internal lending limits. Our Board of Directors reviews and approves our loan policies on an annual basis. We supplement our own supervision of the loan underwriting and approval process with periodic loan audits by experienced external loan specialists who review credit quality, loan documentation and compliance with laws and regulations. We engage in a full complement of lending activities, including:

- commercial real estate loans,
- commercial business lending and trade finance,
- Small Business Administration lending, and
- consumer loans, including automobile loans, home mortgages, credit lines and other personal loans.

As part of our efforts to achieve long-term stable profitability and respond to a changing economic environment in the California Central Valley, we constantly evaluate a variety of options to augment our traditional focus by broadening the services and products we provide. Possible avenues of growth include more branch locations, expanded suite of technology based services and new types of lending.

Loan Procedures. Loan applications may be approved by the Director Loan Committee of our Board of Directors, or by our management or lending officers, to the extent of their loan authority. Our Board of Directors authorizes our lending limits. Our President and Chief Credit Officer are responsible for evaluating the authority limits for individual credit officers and recommending lending limits for all other officers to the board of directors for approval.

We grant individual lending authority to our Chief Executive Officer, Chief Credit Officer, Credit Administrator and to some department managers and loan officers. Our highest management lending authority is combined administrative lending authority for unsecured and secured lending of $2,500,000, which requires the joint approval of either Chief Executive Officer, Chief Credit Officer, Senior Lending Officer and Credit Administrator. Loans for which direct and indirect borrower liability exceeds combined administrative lending authority are referred to our Board of Directors Loan Committee.

At December 31, 2015, the Bank's authorized legal lending limits were $12.5 million for unsecured loans plus an additional $8.3 million for specific secured loans. Legal lending limits are calculated in conformance with California law, which prohibits a bank from lending to any one individual or entity or its related interests an aggregate amount which exceeds 15% of primary capital plus the allowance for loan losses on an unsecured basis, plus an additional 10% on a secured basis. The Bank's primary capital plus allowance for loan losses at December 31, 2015 totaled $81.5 million.

We seek to mitigate the risks inherent in our loan portfolio by adhering to certain underwriting practices. The review of each loan application includes analysis of the applicant's prior credit history, income level, cash flow and financial condition, tax returns, cash flow projections, and the value of any collateral to secure the loan, based upon reports of independent appraisers and audits of accounts receivable or inventory pledged as security. In the case of real estate loans over a specified amount, the review of collateral value includes an appraisal report prepared by an independent, Bank-approved, appraiser.

Real Estate Loans. We offer commercial real estate loans to finance the acquisition of new or the refinancing of existing commercial properties, such as office buildings, industrial buildings, warehouses, hotels, shopping centers, automotive industry facilities and multiple dwellings. At December 31, 2015, real estate loans constituted 84% of our loan portfolio, of which 93% were commercial loans. This includes the real estate loans made by Mother Lode Bank prior to its merger into the Bank in 2015.

Commercial real estate loans typically have 10-year maturities with up to 25-year amortization of principal and interest and loan-to-value ratios of not more than 75% of the appraised value or purchase price, whichever is lower. We usually impose a prepayment penalty during the period within 3 to 5 years of the date of the loan.

Construction loans are comprised of loans on commercial, residential and income producing properties that generally have terms of 1 year, with options to extend for additional periods to complete construction and to accommodate the lease-up period. We usually require 15% equity capital investment by the developer and loan to value ratios of not more than 75% of anticipated completion value.

Miniperm loans finance the purchase and/or ownership of commercial properties, including owner-occupied and income producing properties. We also offer miniperm loans as take-out financing with our construction loans. Miniperm loans are generally made with an amortization schedule ranging from 20 to 25 years, with a lump sum balloon payment due in 3 to 5 years.

Equity lines of credit are revolving lines of credit collateralized by junior deeds of trust on residential real properties. They generally bear a rate of interest that floats with our base rate or the prime rate, and have maturities of 10 years.

We purchase participation interests in loans made by other financial institutions from time to time. These loans are subject to the same underwriting criteria and approval process as loans made directly by us.

Our real estate loans are typically collateralized by first or junior deeds of trust on specific commercial properties and equity lines of credit, and are subject to corporate or individual guarantees from financially capable parties, as available. The properties collateralizing real estate loans are principally located in our primary market areas of the California Central Valley and the Eastern Sierra. Real estate loans typically bear interest rates that float with an established index.

Our real estate portfolio is subject to certain risks, including (i) downturns in the California economy, (ii) significant interest rate fluctuations, (iii) reduction in real estate values in the California Central Valley, (iv) increased competition in pricing and loan structure, and (v) environmental risks, including natural disasters. As a result of the high concentration of the real estate loan in our loan portfolio, potential difficulties in the real estate markets could cause significant increases in nonperforming loans, which would reduce our profits. A decline in real estate values could cause some of our mortgage loans to become inadequately collateralized, which would expose us to a greater risk of loss. Additionally, a decline in real estate values could adversely affect our portfolio of commercial real estate loans and could result in a decline in the origination of such loans. However, we strive to reduce the exposure to such risks and seek to continue to maintain high quality in our real estate loans by (a) reviewing each loan request and each loan renewal individually, (b) using a dual signature approval system for the approval of each loan request for loans over a certain dollar amount, (c) adhering to written loan policies, including, among other factors, minimum collateral requirements, maximum loan-to-value ratio requirements, cash flow requirements and personal guarantees, (d) performing secondary appraisals from time to time, (e) conducting external independent credit review, and (f) conducting environmental reviews, where appropriate. We review each loan request on the basis of our ability to recover both principal and interest in view of the inherent risks. We monitor and stress test our entire portfolio, evaluating debt coverage ratios and loan-to-value ratios, on a quarterly basis. We monitor trends and evaluate exposure derived from simulated stressed market conditions. The portfolio is stratified by owner classification (either owner occupied or non-owner occupied), product type, geography and size.

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As of December 31, 2015, the aggregate loan-to-value of the entire commercial real estate portfolio was 50.8%. Historical data suggests that the Company continues to maintain strong LTV, which has served as a cushion against precipitous reductions in real estate values. Non-owner occupied real estate comprises 40.8% of the Company's total commitments, as of December 31, 2015. The loan-to-value on the non-owner occupied segment was 46.6%, as of December 31, 2015. The highest concentration by product type is office buildings, which comprised 27.1% of total CRE loan commitments outstanding, as of December 31, 2015.

Our portfolio diversity in terms of both product types and geographic distribution, combined with strong debt coverage ratios, a low aggregate loan-to-value and a high percentage of owner-occupied properties, significantly mitigate the risks associated with excessive commercial real estate concentration. These elements contribute strength to our overall real estate portfolio despite the current weakness in the real estate market.

Commercial Business Lending. We offer commercial loans to sole proprietorships, partnerships and corporations, with an emphasis on the real estate related industry. These commercial loans include business lines of credit and commercial term loans to finance operations, to provide working capital or for specific purposes, such as to finance the purchase of assets, equipment or inventory. Since a borrower's cash flow from operations is generally the primary source of repayment, our policies provide specific guidelines regarding required debt coverage and other important financial ratios.

Lines of credit are extended to businesses or individuals based on the financial strength and integrity of the borrower and are secured primarily by real estate, accounts receivable and inventory, and have a maturity of one year or less. Such lines of credit bear an interest rate that floats with the prime rate, LIBOR or another established index.

Commercial term loans are typically made to finance the acquisition of fixed assets, refinance short-term debts or to finance the purchase of businesses. Commercial term loans generally have terms from one to five years. They may be collateralized by the asset being acquired or other available assets and bear interest rates, which either floats with the prime rate, LIBOR or another established index or is fixed for the term of the loan.

Our portfolio of commercial loans is also subject to certain risks, including (i) downturns in the California economy, (ii) significant interest rate fluctuations; and (iii) the deterioration of a borrower's or guarantor's financial capabilities. We attempt to reduce the exposure to such risks through (a) reviewing each loan request and renewal individually, (b) requiring a dual signature approval system, (c) mandating strict adherence to written loan policies, and (d) performing external independent credit review. In addition, we monitor loans based on short-term asset values on a monthly or quarterly basis. In general, during the term of the relationship, we receive and review the financial statements of our borrowing customers on an ongoing basis, and we promptly respond to any deterioration that we note.

Small Business Administration Lending Services. Small Business Administration, or SBA, lending, forms an important part of our business. Our SBA lending service places an emphasis on minority-owned businesses. Our SBA market area includes the geographic areas encompassed by our full-service banking offices in the California Central Valley and in the Eastern Sierra. As an SBA lender, we enable borrowers to obtain SBA loans in order to acquire new businesses, expand existing businesses, and acquire locations in which to do business.

Consumer Loans. Consumer loans include personal loans, auto loans, home improvement loans, home mortgage loans, revolving lines of credit and other loans typically made by banks to individual borrowers. We provide consumer loan products in an effort to diversify our product line.

Our consumer loan portfolio is subject to certain risks, including:

- amount of credit offered to consumers in the market,
- interest rate increases, and
- consumer bankruptcy laws which allow consumers to discharge certain debts.

We attempt to reduce the exposure to such risks through the direct approval of all consumer loans by:

- reviewing each loan request and renewal individually,
- using a dual signature system of approval,
- strictly adhering to written credit policies and,
- performing external independent credit review.

Deposit Activities and Other Sources of Funds

Our primary sources of funds are deposits and loan repayments. Scheduled loan repayments are a relatively stable source of funds, whereas deposit inflows, outflows and unscheduled loan prepayments (which are influenced significantly by general interest rate levels, interest rates available on other investments, competition, economic conditions and other factors) are not as stable. Customer deposits also remain a primary source of funds, but these balances may be influenced by adverse market changes in the industry. We may resort to other borrowings, on an as needed basis, as follows:

on a short-term basis to compensate for reductions in deposit inflows at less than projected levels, and

on a longer-term basis to support expanded lending activities and to match the maturity of repricing intervals of assets.

We offer a variety of accounts for depositors, which are designed to attract both short-term and long-term deposits. These accounts include certificates of deposit, or “CDs”, regular savings accounts, money market accounts, checking and negotiable order of withdrawal, or “NOW”, accounts, savings accounts, health savings accounts and individual retirement accounts, or “IRAs”. These accounts generally earn interest at rates established by management based on competitive market factors and management’s desire to increase or decrease certain types or maturities of deposits. As needs arise, we augment these customer deposits with brokered deposits. The more significant deposit accounts offered by us are described below:

Certificates of Deposit. We offer several types of CDs with a maximum maturity of five years. The substantial majority of our CDs have a maturity of one to twelve months and pay compounded interest typically credited monthly or at maturity.

Regular Savings Accounts. We offer savings accounts that allow for unlimited ATM and in-branch deposits and withdrawals. Interest is compounded daily and paid monthly.

Money Market Account. Money market accounts pay a variable interest rate that is tiered depending on the balance maintained in the account. Minimum opening balances vary. Interest is compounded daily and paid monthly.

Checking and NOW Accounts. Checking and NOW accounts are generally non-interest and interest bearing accounts, respectively, and may include service fees based on activity and balances. NOW accounts pay interest, but require a higher minimum balance to avoid service charges.

Federal Home Loan Bank Borrowings. To supplement our deposits as a source of funds for lending or investment, we borrow funds in the form of advances from the Federal Home Loan Bank. We regularly make use of Federal Home Loan Bank advances as part of our interest rate risk management, primarily to extend the duration of funding to match the longer term fixed rate loans held in the loan portfolio as part of our growth strategy.

As a member of the Federal Home Loan Bank system, we are required to invest in Federal Home Loan Bank stock based on a predetermined formula. Federal Home Loan Bank stock is a restricted investment security that can only be sold to other Federal Home Loan Bank members or redeemed by the Federal Home Loan Bank. As of December 31, 2015, we owned $2,958,000 in FHLB stock.

Advances from the Federal Home Loan Bank are typically secured by our entire real estate loan portfolio, which includes residential and commercial loans. At December 31, 2015, our borrowing limit with the Federal Home Loan Bank was approximately $198 million.

Internet Banking

Since August 1, 2001, we have offered Internet banking service, which allows our customers to access their deposit accounts through the Internet. Customers are able to obtain transaction history and account information, transfer funds between accounts and make on-line bill payments. We intend to improve and develop our Internet banking products and delivery channels as the need arises and our resources permit.

Other Services

We also offer ATMs located at branch offices as well as seven other ATMs at various off site locations, and customer access to an ATM network.

Marketing

Our marketing relies principally upon local advertising and promotional activity and upon personal contacts by our directors, officers and shareholders to attract business and to acquaint potential customers with our personalized services. We emphasize a high degree of personalized client service in order to be able to provide for each customer’s banking needs. Our marketing approach emphasizes the advantages of dealing with an independent, locally managed and state chartered bank to meet the particular needs of consumers, professionals and business customers in the community. Our management continually evaluates all of our banking services with regard to their profitability and efforts and makes determinations based on these evaluations whether to continue or modify our business plan, where appropriate.

We do not currently have any plans to develop any new lines of business, which would require a material amount of capital investment on our part.

Competition

Regional Branch Competition. We consider our primary service area to be composed of the counties of San Joaquin, Stanislaus, Tuolumne, Inyo and Mono Counties, of California. The banking business in California generally, and in our primary service area, specifically, is competitive with respect to both loans and deposits and is dominated by a relatively small number of major banks which have many offices operating over wide geographic areas. These include Wells Fargo Bank, Bank of America, JP Morgan Chase Bank and Bank of the West. We compete for deposits and loans principally with these banks, as well as with savings and loan associations, thrift and loan associations, credit unions, mortgage companies, insurance companies, offerors of money market accounts and other lending institutions.

Among the advantages of these institutions are their ability to finance extensive advertising campaigns and to allocate their investment assets to regions of highest yield and demand, their ability to offer certain services, such as international banking and trust services which are not offered directly by the Company and, the ability by virtue of their greater total capitalization, to have substantially higher lending limits than we do. In addition, as a result of increased consolidation and the passage of interstate banking legislation there is and will continue to be increased competition among banks, savings and loan associations and credit unions for the deposit and loan business of individuals and businesses.

As of June 30, 2015, our primary service areas contained one hundred seventy-four (174) banking offices, with approximately $13.8 billion in total deposits. As of June 30, 2015, we had total deposits of approximately $684 million, which represented approximately 5.0% of the total deposits in the Bank's primary service area. There can be no assurance that the Bank will maintain its competitive position against current and potential competitors, especially those with greater resources than the Bank. The deposits of the four (4) largest competing banks averaged approximately $122 million per office as of June 30, 2015.

In order to compete with major financial institutions in our primary service areas, we use to the fullest extent the flexibility that our independent status permits. This includes an emphasis on specialized services, local promotional activity, and personal contacts by our officers, directors and employees. In the event that there are customers whose needs exceed our lending limits, we may arrange for such loans on a participation basis with other financial institutions. We also assist customers who require other services that we do not offer by obtaining such services from correspondent banks. However, no assurance can be given that our continued efforts to compete with other financial institutions will be successful.

In addition to other banks, our competitors include savings institutions, credit unions, and numerous non-banking institutions, such as finance companies, leasing companies, insurance companies, brokerage firms, and investment banking firms. In recent years, increased competition has also developed from specialized finance and non-finance companies that offer money market and mutual funds, wholesale finance, credit card, and other consumer finance services, including on-line banking services and personal finance software. Strong competition for deposit and loan products affects the rates of those products as well as the terms on which they are offered to customers.

Other Competitive Factors. The more general competitive trends in the industry include increased consolidation and competition. Strong competitors, other than financial institutions, have entered banking markets with focused products targeted at highly profitable customer segments. Many of these competitors are able to compete across geographic boundaries and provide customers increasing access to meaningful alternatives to banking services in nearly all significant products areas. Mergers between financial institutions have placed additional pressure on banks within the industry to streamline their operations, reduce expenses, and increase revenues to remain competitive. Competition has also intensified due to the federal and state interstate banking laws, which permit banking organizations to expand geographically, and the California market has been particularly attractive to out-of-state institutions. The Financial Modernization Act, which has made it possible for full affiliations to occur between banks and securities firms, insurance companies, and other financial companies, is also expected to intensify competitive conditions.

Technological innovations have also resulted in increased competition in the financial services industry. Such innovations have, for example, made it possible for non-depository institutions to offer customers automated transfer payment services that were previously considered traditional banking products. In addition, many customers now expect a choice of several delivery systems and channels, including telephone, mail, home computer, mobile devices, ATMs, self-service branches and/or in-store branches.

Business Concentration. No individual or single group of related accounts is considered material in relation to our total assets or deposits, or in relation to our overall business. However, approximately 84% of our loan portfolio held for investment at December 31, 2015 consisted of real estate-related loans, including construction loans, miniperm loans, real estate mortgage loans and commercial loans secured by real estate. Moreover, our business activities are currently focused primarily in Central California, with the majority of our business concentrated in San Joaquin, Stanislaus, Tuolumne, Inyo and Mono Counties. Consequently, our results of operations and financial condition are dependent upon the general trends in the Central California economies and, in particular, the residential and commercial real estate markets. In addition, the concentration of our operations in Central California exposes us to greater risk than other banking companies with a wider geographic base in the event of catastrophes, such as earthquakes, fires and floods in this region.

Employees

As of December 31, 2015, we had 167 employees (135 full-time employees and 32 part-time employees). None of our employees are currently represented by a union or covered by a collective bargaining agreement. We added 9 employees as a result of the merger of Mother Lode Bank into the Bank.

Economic Conditions and Legislative and Regulatory Developments

As it is the case with financial institutions with our size and scope, our profitability primarily depends on interest rate differentials. Interest rates are highly sensitive to many factors that are beyond our control and cannot be predicted, such as inflation, recession and unemployment, and the impact that future changes in domestic and foreign economic conditions might have on the Company. A more detailed discussion of the Company's interest rate risks and the mitigation of those risks is included in Item 7A. Quantitative and Qualitative Disclosures About Market Risk, in this Annual Report on Form 10-K.

Our business is also influenced by the monetary and fiscal policies of the Federal government and the policies of regulatory agencies. The Federal Reserve Board implements national monetary policies (with objectives such as maintaining price stability, stimulating growth and reducing unemployment) through its open-market operations in U.S. Government securities, by adjusting the required level of reserves for depository institutions subject to its reserve requirements, and by varying the target Federal funds and discount rates applicable to borrowings by depository institutions. The actions of the Federal Reserve Board in these areas influence the growth of bank loans, investments, and deposits and also affect interest earned on interest-earning assets and interest paid on interest-bearing liabilities. The nature and impact of any future changes in monetary and fiscal policies on us cannot be predicted.

From time to time, federal and state legislation is enacted that may have the effect of materially increasing the cost of doing business, limiting or expanding permissible activities, or affecting the competitive balance between banks and other financial services providers. In response to the economic downturn and financial industry instability, legislative and regulatory initiatives were, and are expected to continue to be, introduced and implemented, which substantially intensify the regulation of the financial services industry. Moreover, in light of the economic environment over the last three to five years, bank regulatory agencies have responded to concerns and trends identified in examinations. While their response resulted in the increased issuance and continuation of enforcement actions against financial institutions towards the end of the last decade and into the beginning of this decade, the level of such actions compared to the peak in 2010 has decreased.

Supervision and Regulation in General

The banking and financial services business in which we engage is highly regulated. Such regulation is intended, among other things, to protect depositors insured by the FDIC and the entire banking system. These regulations affect our lending practices, consumer protections, capital structure, investment practices and dividend policy.

The Company is a legal entity separate and distinct from the Bank. The Company and the Bank are each subject to supervision and regulation by a number of federal and state agencies and regulatory bodies, as outlined below.

Upon effectiveness of the bank holding company reorganization on July 2, 2008, the Company became subject to regulation under the Bank Holding Company Act of 1956, as amended ("BHCA"). As a bank holding company, the Company is regulated and is subject to inspection, examination and supervision by the Federal Reserve Board. It is also subject to the California Financial Code, as well as limited oversight by the DBO and the FDIC. Under the Federal Reserve Board's regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks. The BHCA regulates the activities of holding companies including acquisitions, mergers, and consolidations and, together with the Gramm-Leach Bliley Act of 1999, the scope of allowable banking activities.

As a California-state chartered bank, the Bank is subject to primary supervision, examination and regulation by the DBO and the Federal Reserve Board. The Federal Reserve Board is the primary federal regulator of state member banks. The Bank is also subject to regulation by the FDIC, which insures the Bank's deposits as permitted by law. If, as a result of an examination of a bank, the Federal Reserve Board determines that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of its operations are unsatisfactory, or that it or its management is violating or has violated any law or regulation, various remedies are available to the Federal Reserve Board. Such remedies include the power to: enjoin "unsafe or unsound" practices; require affirmative action to correct any conditions resulting from any violation or practice; issue an administrative order that can be judicially enforced; direct an increase in capital; restrict growth; assess civil monetary penalties; remove officers and directors; institute a receivership; and, ultimately terminate the bank's deposit insurance, which would result in a revocation of its charter. The DBO separately holds many of the same remedial powers.

The commercial banking business is also influenced by the monetary and fiscal policies of the federal government and the policies of the Board of Governors of the Federal Reserve System, also known as the FRB or the Federal Reserve Board. As a member of the Federal Reserve System, we are subject to certain regulations of the Board of Governors of the Federal Reserve System. The regulations of these agencies govern most aspects of our business, including the filing of periodic reports, and activities relating to dividends, investments, loans, borrowings, capital requirements, certain check-clearing activities, branching, mergers and acquisitions, reserves against deposits, and numerous other areas. Supervision, legal action and examination of us by the FRB is generally intended to protect depositors and is not intended for the protection of our shareholders. The Federal Reserve Board implements national monetary policies (with objectives such as curbing inflation and combating recession) by its open-market operations in United States Government securities, by adjusting the required level of reserves for financial intermediaries subject to its reserve requirements and by varying the discount rates applicable to borrowings by depository institutions. The actions of the Federal Reserve Board in these areas influence the growth of bank loans, investments and deposits and affects interest rates charged on loans and paid on deposits. Indirectly such actions may also impact the ability of non-bank financial institutions to compete with us. The nature and impact of any future changes in monetary policies cannot be predicted.

The laws, regulations and policies affecting financial services businesses are continuously under review by Congress and state legislatures and federal and state regulatory agencies. From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial intermediaries. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial intermediaries are frequently made in Congress, in the California legislature and by various bank regulatory agencies and other professional agencies. Changes in the laws, regulations or policies that impact us cannot necessarily be predicted, but they may have a material effect on our business and earnings.

The federal and state bank regulatory agencies may respond to concerns and trends identified in examinations by issuing enforcement actions to, and entering into cease and desist orders, consent orders and memoranda of understanding with, financial institutions requiring action by management and boards of directors to address credit quality, liquidity, risk management and capital adequacy concerns, as well as other safety and soundness or compliance issues. Banks and bank holding companies are also subject to examination and potential enforcement actions by their state regulatory agencies.

Bank Holding Company and Bank Regulation

Bank holding companies and their subsidiaries are subject to significant regulation and restrictions by Federal and State laws and regulatory agencies. Federal and State laws, regulations and restrictions, which may affect the cost of doing business, limit permissible activities and expansion or impact the competitive balance between banks and other financial services providers, are intended primarily for the protection of depositors and the FDIC deposit insurance fund ("DIF"), and secondarily for the stability of the U.S. banking system. They are not intended for the benefit of shareholders of financial institutions. The following discussion of key statutes and regulations to which the Company and the Bank are subject is a summary and does not purport to be complete nor does it address all applicable statutes and regulations. This discussion is qualified in its entirety by reference to the statutes and regulations referred to in this discussion.

The wide range of requirements and restrictions contained in both Federal and State banking laws include:

Requirements that bank holding companies serve as a source of strength for their banking subsidiaries. In addition, the regulatory agencies have "prompt corrective action" authority to limit activities and order an assessment of a bank holding company if the capital of a bank subsidiary falls below capital levels required by the regulators.

Limitations on dividends payable to shareholders. A substantial portion of the Company's funds to pay dividends or to pay principal and interest on our debt obligations is derived from dividends paid by the Bank. The Company's and the Bank's ability to pay dividends is subject to legal and regulatory restrictions. The Federal Reserve Board has authority to prohibit bank holding companies from paying dividends if such payment is deemed to be an unsafe or unsound practice.

Limitations on dividends payable by bank subsidiaries. These dividends are subject to various legal and regulatory restrictions. The federal banking agencies have indicated that paying dividends that deplete a depositary institution's capital base to an inadequate level would be an unsafe and unsound banking practice. Moreover, the federal agencies have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings.

Safety and soundness requirements. Banks must be operated in a safe and sound manner and meet standards applicable to internal controls, information systems, internal audit, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, as well as other operational and management standards. These safety and soundness requirements give bank regulatory agencies significant latitude in exercising their supervisory authority and their authority to initiate informal or formal enforcement action.

Requirements for approval of acquisitions and activities. Prior approval or non-objection of the applicable federal regulatory agencies is required for most acquisitions and mergers and in order to engage in certain non-banking activities and activities that have been determined by the Federal Reserve to be financial in nature, incidental to financial activities, or complementary to a financial activity. Laws and regulations governing state-chartered banks contain similar provisions concerning acquisitions and activities.

The Community Reinvestment Act (the "CRA"). The CRA requires that banks help meet the credit needs in their communities, including the availability of credit to low and moderate income individuals. If the Company or the Bank fails to adequately serve their communities, penalties may be imposed, including denials of applications for branches, to add subsidiaries and affiliates, or to merge with or purchase other financial institutions.

The Bank Secrecy Act, the USA Patriot Act, and other anti-money laundering laws. These laws and regulations require financial institutions to assist U.S. Government agencies in detecting and preventing money laundering and other illegal acts by maintaining policies, procedures and controls designed to detect and report money laundering, terrorist financing, and other suspicious activity.

Limitations on the amount of loans to one borrower and its affiliates and to executive officers and directors.

Limitations on transactions with affiliates.

Restrictions on the nature and amount of any investments in, and ability to underwrite certain securities.

Requirements for opening of branches intra- and interstate.

Fair lending and truth in lending laws to ensure equal access to credit and to protect consumers in credit transactions.

Provisions of the Gramm-Leach-Bliley Act of 1999 ("GLB Act") and other federal and state laws dealing with privacy for nonpublic personal information of customers.

The following discussion summarizes certain significant laws, rules and regulations affecting both the Company and the Bank. The Bank addresses the many state and federal regulations it is subject to through a comprehensive compliance program that addresses the various risks associated with these issues. The following discussion is not meant to cover all applicable rules and regulations and it is qualified in its entirety by reference to such laws, rules and regulations which may change from time to time.

The Dodd-Frank Wall Street Reform and Consumer Protection Act

The events of the past several years have led to numerous new laws and regulatory pronouncements in the United States and internationally for financial institutions. The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), enacted in 2010, is one of the most far reaching legislative actions affecting the financial services industry in decades and significantly restructures the financial regulatory regime in the United States.

The Dodd-Frank Act broadly affects the financial services industry by creating new resolution authorities, requiring ongoing stress testing of capital, mandating higher capital and liquidity requirements, increasing regulation of executive and incentive-based compensation and requiring numerous other provisions aimed at strengthening the sound operation of the financial services sector depending, in part, on the size of the financial institution. Among other things, the Dodd-Frank Act provides for:

capital standards applicable to bank holding companies may be no less stringent than those applied to insured depository institutions;

annual stress tests and early remediation or so-called living wills are required for larger banks with more than $50 billion of assets as well risk committees of their boards of directors that include a risk expert and such requirements may have the effect of establishing new best practices standards for smaller banks;

trust preferred securities must generally be deducted from Tier 1 capital over a three-year phase-in period ending in 2016, although depository institution holding companies with assets of less than $15 billion as of year-end 2009 are grandfathered with respect to such securities for purposes of calculating regulatory capital;

the assessment base for federal deposit insurance was changed to consolidated assets less tangible capital instead of the amount of insured deposits, which generally increased the insurance fees of larger banks, but had relatively less impact on smaller banks;

repeal of the federal prohibition on the payment of interest on demand deposits, including business checking accounts, and made permanent the $250,000 limit for federal deposit insurance;

the establishment of the Consumer Finance Protection Bureau (the “CFPB”) with responsibility for promulgating regulations designed to protect consumers’ financial interests and prohibit unfair, deceptive and abusive acts and practices by financial institutions, and with authority to directly examine those financial institutions with $10 billion or more in assets for compliance with the regulations promulgated by the CFPB;

limits, or places significant burdens and compliance and other costs, on activities traditionally conducted by banking organizations, such as originating and securitizing mortgage loans and other financial assets, arranging and participating in swap and derivative transactions, proprietary trading and investing in private equity and other funds; and

the establishment of new compensation restrictions and standards regarding the time, manner and form of compensation given to key executives and other personnel receiving incentive compensation, including documentation and governance, proxy access by stockholders, deferral and claw-back requirements.

As required by the Dodd-Frank Act, federal regulators have adopted regulations to (i) increase capital requirements on banks and bank holding companies pursuant to Basel III, and (ii) implement the so-called “Volcker Rule” of the Dodd-Frank Act, which significantly restricts certain activities by covered bank holding companies, including restrictions on proprietary trading and private equity investing.

Many of the regulations to implement the Dodd-Frank Act have not yet been published for comment or adopted in final form and a number of the regulations that have been adopted in final form will take effect over several years, making it difficult to anticipate the overall financial impact on the Company and the Bank, our customers or the financial industry more generally. Individually and collectively, these regulations resulting from the Dodd-Frank Act may materially and adversely affect the Company's and the Bank's business, financial condition, and results of operations. Provisions in the legislation that require revisions to the capital requirements of the Company and the Bank could require the Company and the Bank to seek additional sources of capital in the future.

Volcker Rule

The final rules adopted on December 10, 2013, to implement a part of the Dodd-Frank Act commonly referred to as the "Volcker Rule", prohibit insured depository institutions and companies affiliated with insured depository institutions ("banking entities") from engaging in short-term proprietary trading of certain securities, derivatives, commodity futures and options on these instruments, for their own account. The final rules also impose limits on banking entities' investments in, and other relationships with, hedge funds or private equity funds. These rules became effective on April 1, 2014. Certain collateralized debt obligations ("CDOs"), securities backed by trust preferred securities which were initially defined as covered funds subject to the investment prohibitions, have been exempted to address the concern that many community banks holding such CDOs securities may have been required to recognize significant losses on those securities.

Like the Dodd-Frank Act, the final rules provide exemptions for certain activities, including market making, underwriting, hedging, trading in government obligations, insurance company activities, and organizing and offering hedge funds or private equity funds. The final rules also clarify that certain activities are not prohibited, including acting as agent, broker, or custodian.

The compliance requirements under the final rules vary based on the size of the banking entity and the scope of activities conducted. Banking entities with significant trading operations will be required to establish a detailed compliance program and their CEOs will be required to attest that the program is reasonably designed to achieve compliance with the final rule. Independent testing and analysis of an institution's compliance program will also be required. The final rules reduce the burden on smaller, less-complex institutions by limiting their compliance and reporting requirements. Additionally, a banking entity that does not engage in covered trading activities will not need to establish a compliance program. The Company and the Bank held no investment positions at December 31, 2014 or 2015 that were subject to the final rule. Therefore, while these new rules may require us to conduct certain internal analysis and reporting, we believe that they will not require any material changes in our operations or business.

Capital Adequacy Requirements

Banks and bank holding companies are subject to various capital requirements administered by state and federal banking agencies. Capital adequacy guidelines involve quantitative measures of assets, liabilities and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting and other factors.

The federal banking agencies have adopted risk-based minimum capital guidelines intended to provide a measure of capital that reflects the degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets and transactions which are recorded as off balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off balance sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as federal banking agencies, to 100% for assets with relatively high credit risk. The higher the category, the more risk a bank is subject to and thus the more capital that is required.

The regulatory agencies' risk-based capital guidelines are based upon capital accords of the internal Basel Committee on Bank Supervision ("Basel Committee"), a committee of central banks and bank supervisors/regulators from the major industrialized countries that develops broad policy guidelines, which each country's supervisors can use to determine the supervisory policies they apply to their home jurisdiction. In December 2010, the Basel Committee released its final framework for strengthening international capital and liquidity regulation, now officially identified as "Basel III." Basel III, when fully phased-in, would require bank holding companies and their bank subsidiaries to maintain substantially more capital than currently required, with a greater emphasis on common equity. The Basel III capital framework, among other things:

- introduces as a new capital measure, Common Equity Tier 1 ("CET1"), more commonly known in the United States as "Tier 1 Common," and defines CET1 narrowly by requiring that most adjustments to regulatory capital measures be made to CET1 and not to the other components of capital, and expands the scope of the adjustments as compared to existing regulations;

- when fully phased in, requires banks to maintain: (i) a newly adopted international standard, a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%); (ii) an additional "SIFI buffer" for those large institutions deemed to be systemically important, ranging from 1.0% to 2.5%, and up to 3.5% under certain conditions; (iii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation); (iv) a minimum ratio of Total (that is, Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation); and (v) as a newly adopted international standard, a minimum leverage ratio of 3%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (as the average for each quarter of the month-end ratios for the quarter); and

- an additional “countercyclical capital buffer,” generally to be imposed when national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk, that would be a CET1 add-on to the capital conservation buffer in the range of 0% to 2.5% when fully implemented.

In July 2014, the U.S. banking agencies approved the U.S. version of Basel III. The federal bank regulatory agencies adopted version of Basel III revises the risk-based and leverage capital requirements and the method for calculating risk-weighted assets to make them consistent with Basel III and to meet the requirements of the Dodd-Frank Act. Although many of the rules contained in these final regulations are applicable only to large, internationally active banks, some of them will apply on a phased in basis to all banking organizations, including the Company and the Bank. Among other things, the rules establish a new minimum common equity Tier 1 ratio (4.5% of risk-weighted assets), a higher minimum Tier 1 risk-based capital requirement (6.0% of risk-weighted assets) and a minimum non-risk-based leverage ratio (4.00% eliminating a 3.00% exception for higher rated banks). The new additional capital conservation buffer of 2.5% of risk weighted assets over each of the required capital ratios will be phased in from 2016 to 2019 and must be met to avoid limitations on the ability of the Bank to pay dividends, repurchase shares or pay discretionary bonuses. The additional "countercyclical capital buffer" is also required for larger and more complex institutions. The new rules assign higher risk weighting to exposures that are more than 90 days past due or are on nonaccrual status and certain commercial real estate facilities that finance the acquisition, development or construction of real property. The rules also change the permitted composition of Tier 1 capital to exclude trust preferred securities, mortgage servicing rights and certain deferred tax assets and include unrealized gains and losses on available for sale debt and equity securities (with a one-time opt out option for Standardized Banks (banks with less than $250 billion of total consolidated assets and less than $10 billion of foreign exposures)). The rules, including alternative requirements for smaller community financial institutions like the Company, would be phased in through 2019. The implementation of the Basel III framework for the Company and the Bank commenced on January 1, 2015.

The Bank is well capitalized. As of December 31, 2015 and 2014, the Bank's Total Risk-Based Capital Ratio was 12.2% and 14.5%, and our Tier 1 Risk-Based Capital Ratio was 11.1% and 13.2%, respectively. As of December 31, 2015, the Bank's Common Equity Tier 1 Risk-Based Capital Ratio was 11.1%.

In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to total average assets, referred to as the leverage ratio. Banks that have received the highest rating of the five categories used by regulators to rate banks and are not anticipating or experiencing any significant growth must maintain a ratio of Tier 1 capital (net of all intangibles) to adjusted total assets, or "Leverage Capital Ratio", of at least 3%. All other institutions are required to maintain a leverage ratio of at least 100 to 200 basis points above the 3% minimum, for a minimum of 4% to 5%. Pursuant to federal regulations, banks must maintain capital levels commensurate with the level of risk to which they are exposed, including the volume and severity of problem loans. As of December 31, 2015 and 2014, the Bank's Leverage Capital Ratios were 9.1% and 10.2%, respectively.

Federal banking regulators may set capital requirements higher than the minimums described above for financial institutions whose circumstances warrant it. For example, a financial institution experiencing or anticipating significant growth may be expected to maintain capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets.

A bank may be treated as though it were in the next lower capital category if, after notice and the opportunity for a hearing, the appropriate federal agency finds an unsafe or unsound condition or practice so warrants, but no bank may be treated as “critically undercapitalized” unless its actual capital ratio warrants such treatment.

At each successively lower capital category, an insured bank is subject to increased restrictions on its operations. For example, a bank is generally prohibited from paying management fees to any controlling persons or from making capital distributions, if to do so would make the Bank “undercapitalized.” Asset growth and branching restrictions apply to undercapitalized banks, which are required to submit written capital restoration plans meeting specified requirements (including a guarantee by the parent holding company, if any). “Significantly undercapitalized” banks are subject to broad regulatory authority, including among other things, capital directives, forced mergers, restrictions on the rates of interest they may pay on deposits, restrictions on asset growth and activities, and prohibitions on paying certain bonuses without FRB approval. Even more severe restrictions apply to critically undercapitalized banks. Most importantly, except under limited circumstances, the appropriate federal banking agency is required to appoint a conservator or receiver for an insured bank not later than 90 days after the Bank becomes critically undercapitalized.

In addition to measures taken under the prompt corrective action provisions, insured banks may be subject to potential actions by federal regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation or any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include the issuance of cease and desist orders, termination of insurance of deposits (in the case of a bank), the imposition of civil money penalties, the issuance of directives to increase capital, formal and informal agreements, or removal and prohibition orders against "institution-affiliated" parties.

Dividends

The payment of cash dividends by the Bank to the Company is subject to restrictions set forth in the California Financial Code (the "Code"). Prior to any distribution from the Bank to the Company, a calculation is made to ensure compliance with the provisions of the Code and to ensure that the Bank remains within capital guidelines set forth by the DBO and the FRB. In the event that the intended distribution from the Bank to the Company exceeds the restriction in the Code, advance approval from FRB is required. Management anticipates that there will be sufficient earnings at the Bank level to provide dividends to the Company to meet its cash requirements for 2016.

Safety and Soundness Standards

Federal banking agencies have also adopted guidelines establishing safety and soundness standards for all insured depository institutions. Those guidelines relate to internal controls, information systems, internal audit systems, loan underwriting and documentation, compensation and interest rate exposure. In general, the standards are designed to assist the federal banking agencies in identifying and addressing problems at insured depository institutions before capital becomes impaired. If an institution fails to meet these standards, the appropriate federal banking agency may require the institution to submit a compliance plan and institute enforcement proceedings, if an acceptable compliance plan is not submitted.

Deposit Insurance and FDIC Insurance Assessments

Our deposits are insured by the FDIC to the maximum amount permitted by law, which is currently $250,000 per depositor. The Dodd-Frank Act made the deposit insurance coverage permanent at the $250,000 level retroactive to

January 1, 2008.

On February 7, 2011, as required by the Dodd-Frank Act, the FDIC approved a rule that changes the FDIC insurance assessment base from adjusted domestic deposits to a bank's average consolidated total assets minus average tangible equity, defined as Tier 1 capital. Since the new base is larger than the current base, the new rule lowers assessment rates to between 2.5 and 9 basis points on the broader base for banks in the lowest risk category, and 30 to 45 basis points for banks in the highest risk category. The change was effective beginning with the second quarter of 2011. Since we have a solid core deposit base and do not rely heavily on borrowings and brokered deposits, the benefit of the lower assessment rate (which has dropped by approximately half for us) significantly outweighed the effect of a wider assessment base.

The Dodd-Frank act also provided depositors at all FDIC-insured institutions with unlimited deposit insurance coverage on traditional checking accounts that do not pay interest and Interest on Lawyers Trust Accounts beginning December 31, 2010 through the end of 2012, when this provision expired.

Community Reinvestment Act

We are subject to certain requirements and reporting obligations involving the Community Reinvestment Act, or "CRA". The CRA generally requires federal banking agencies to evaluate the record of financial institutions in meeting the credit needs of local communities, including low and moderate-income neighborhoods. The CRA further requires that a record be kept of whether a financial institution meets its community credit needs, which record will be taken into account when evaluating applications for, among other things, domestic branches, consummating mergers or acquisitions, or holding company formations. In measuring a bank's compliance with its CRA obligations, the regulators now utilize a performance-based evaluation system, which bases CRA ratings on the Company's actual lending service and investment performance, rather than on the extent to which the institution conducts needs assessments, documents community outreach activities or complies with other procedural requirements. In connection with its assessment of CRA performance, the FRB assigns a rating of "outstanding," "satisfactory," "needs to improve" or "substantial noncompliance." Our CRA performance is evaluated by the FRB under the intermediate small bank requirements. The FRB's last CRA performance examination was performed on us and completed in July of 2013 and we received an overall "Satisfactory" CRA Assessment Rating.

Anti-Money Laundering Regulations

A series of banking laws and regulations beginning with the Bank Secrecy Act in 1970 require banks to prevent, detect, and report illicit or illegal financial activities to the federal government to prevent money laundering, international drug trafficking, and terrorism. Under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and "know your customer" standards in their dealings with high risk customers, foreign financial institutions, and foreign individuals and entities. We have extensive controls to comply with these requirements.

Privacy and Data Security

The Gramm-Leach Bliley Act ("GLBA") of 1999 imposed requirements on financial institutions with respect to consumer privacy. The GLBA generally prohibits disclosure of consumer information to non-affiliated third parties unless the consumer has been given the opportunity to object and has not objected to such disclosure. Financial institutions are further required to disclose their privacy policies to consumers annually. The GLBA also directs federal regulators to prescribe standards for the security of consumer information. We are subject to such standards, as well as standards for notifying consumers in the event of a security breach. We must disclose our privacy policy to consumers and permit consumers to "opt out" of having non-public customer information disclosed to third parties. We are required to have an information security program to safeguard the confidentiality and security of customer information and to ensure proper disposal. Customers must be notified when unauthorized disclosure involves sensitive customer information that may be misused.

Other Consumer Protection Laws and Regulations

Bank regulatory agencies are increasingly focusing on compliance with consumer protection laws and regulations. Examination and enforcement has become intense, and banks have been advised to monitor compliance carefully with various consumer protection laws and their implementing regulations. For example, the federal Interagency Task Force on Fair Lending issued a policy statement on discrimination in home mortgage lending describing three methods that federal agencies will use to prove discrimination: overt evidence of discrimination, evidence of disparate treatment, and evidence of disparate impact. In addition to CRA and fair lending requirements, we are subject to numerous other federal consumer protection statutes and regulations. Due to heightened regulatory concern related to compliance with consumer protection laws and regulations generally, we may incur additional compliance costs or be required to expend additional funds for investments in the local communities we serve.

Restriction on Transactions between Member Banks and their Affiliates

Transactions between the Company and the Bank are quantitatively and qualitatively restricted under Sections 23A and 23B of the Federal Reserve Act and Federal Reserve Regulation W. Section 23A places restrictions on the Bank's "covered transactions" with the Company, including loans and other extensions of credit, investments in the securities of, and purchases of assets from the Company. Section 23B requires that certain transactions, including all covered transactions, be on market terms and conditions. Federal Reserve Regulation W combines statutory restrictions on transactions between the Bank and the Company with FRB interpretations in an effort to simplify compliance with Sections 23A and 23B.

The Sarbanes-Oxley Act of 2002

On July 30, 2002, President Bush signed into law The Sarbanes-Oxley Act of 2002, or "Sarbanes-Oxley Act". The Sarbanes-Oxley Act addresses accounting oversight and corporate governance matters relating to the operations of public companies. During 2003, the Commission issued a number of regulations under the directive of the Sarbanes-Oxley Act significantly increasing public company governance-related obligations and filing requirements, including:

the establishment of an independent public oversight of public company accounting firms by a board that will set auditing, quality and ethical standards for and have investigative and disciplinary powers over such accounting firms,

the enhanced regulation of the independence, responsibilities and conduct of accounting firms which provide auditing services to public companies,

the increase of penalties for fraud related crimes,

the enhanced disclosure, certification, and monitoring of financial statements, internal financial controls and the audit process, and

the enhanced and accelerated reporting of corporate disclosures and internal governance.

Furthermore, in November 2003, in response to the directives of the Sarbanes-Oxley Act, NASDAQ adopted substantially expanded corporate governance criteria for the issuers of securities quoted on the NASDAQ markets. The new NASDAQ rules govern, among other things, the enhancement and regulation of corporate disclosure and internal governance of listed companies and of the authority, role and responsibilities of their boards of directors and, in particular, of "independent" members of such boards of directors, in the areas of nominations, corporate governance, compensation and the monitoring of the audit and internal financial control processes.

The Sarbanes-Oxley Act, the Commission rules promulgated thereunder, and the new NASDAQ governance requirements have required the Company to review its current procedures and policies to determine whether they comply with the new legislation and its implementing regulations. The Company is primarily responsible for ensuring compliance with Sarbanes-Oxley and the NASDAQ governance rules, as applicable.

Securities Laws and Corporate Governance

The Company is subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, both as administered by the SEC. As a company listed on the NASDAQ Global Select Market, the Company is subject to NASDAQ listing standards for listed companies.

As discussed above, we are also subject to the Sarbanes-Oxley Act of 2002, provisions of the Dodd-Frank Act, and other federal and state laws and regulations which address, among other issues, required executive certification of financial presentations, corporate governance requirements for board audit committees and their members, and disclosure of controls and procedures and internal control over financial reporting, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. NASDAQ has also adopted corporate governance rules, which are intended to allow shareholders and investors to more easily and efficiently monitor the performance of companies and their directors.

Finally, the Company is subject to the provisions of the California General Corporation Law, while the Bank is also subject to the California Financial Code provisions.

Environmental Regulations

In the course of our business, we may foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, as the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we ever become subject to significant environmental liabilities, our business, financial condition, liquidity and results of operations could be materially and adversely affected.

Other Pending and Proposed Legislation

Other legislative and regulatory initiatives which could affect us and the banking industry, in general, are pending and additional initiatives may be proposed or introduced before the United States Congress, the California legislature and other governmental bodies in the future. Such proposals, if enacted, may further alter the structure, regulation and competitive relationship among financial institutions, and may subject us to increased regulation, disclosure and reporting requirements. In addition, the various banking regulatory agencies often adopt new rules and regulations to implement and enforce existing legislation. We cannot predict whether, or in what form, any such legislation or regulations may be enacted or the extent to which our business would be affected thereby.

Available Information

The Company maintains an Internet website at http://www.ovcb.com. The Company makes available its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and other information related to the Company free of charge, through this site as soon as reasonably practicable after it electronically files those documents with, or otherwise furnishes them to, the SEC. The Company’s website also contains its Committee Charters, Code of Ethics, Code of Conduct and Corporate Governance Guidelines. The Company’s internet website and the information contained therein or connected thereto are not intended to be incorporated into this annual report on Form 10-K.

In addition, copies of our filings are available by requesting them in writing or by phone from:

Corporate Secretary

Oak Valley Bancorp

125 North Third Avenue
Oakdale, California

209-844-7578

ITEM 1A. RISK FACTORS

Not applicable.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our main office is located in a complex at 125 North Third Avenue, Oakdale, CA 95361, in downtown Oakdale and houses our primary loan production, operations, and administrative offices. The building has an automated teller machine and onsite parking. The Company's Oakdale complex includes the adjacent corporate headquarter building and occupies approximately 20,000 square feet of space.

Property Location and Address	**Square Footage**	**Lease Expiration Date**	**Lease Extension Options**
Oakdale, 125 N. 3rd Ave.	9,600	n/a*	n/a*
Oakdale, 338 F Street	9,860	n/a*	n/a*
Sonora, 14580 Mono Way	2,500	4/2018	two, 5-year term extensions
Modesto, 12th & I Street	4,500	3/2021	one, 5-year term extensions
Bridgeport, 166 Main Street	2,875	n/a*	n/a*
Mammoth Lakes, 170 Mountain Blvd.	1,856	n/a*	n/a*
Bishop, 351 North Main Street	3,680	8/2019	one, 5-year term extensions
Modesto, 4120 Dale Road	4,500	3/2021	one, 5-year term extensions
Turlock, 2001 Geer Road	2,400	1/2020	one, 5-year term extensions
Patterson, 20 Plaza Circle	2,100	n/a*	n/a*
Escalon, 1910 McHenry Ave.	3,500	4/2021	two, 5-year term extensions
Ripon, 150 North Wilma Ave.	1,800	12/2020	No remaining extensions
Stockton, 2935 West March Lane	8,000	12/2022	two, 5-year term extensions
Modesto, 3508 McHenry Ave.	5,400	n/a*	n/a*
Manteca, 191 W. North St.	2,800	5/2021	one, 5-year term extensions
Tracy, 1034 N. Central Ave.	5,000	7/2024	two, 5-year term extensions
Sonora, 85 Mono Way	4,000	12/2030	two, 5-year term extensions

* The Company owns this property.

Management has determined that all of its premises are adequate for its present and anticipated level of business.

ITEM 3. LEGAL PROCEEDINGS

From time to time, the Company is a party to claims and legal proceedings arising in the ordinary course of business. Our management evaluates its exposure to these claims and proceedings individually and in the aggregate and provides for potential losses on such litigation if the amount of the loss is estimable and the loss is probable.

To our knowledge, there are no material litigation matters pending at the current time. Although the results of any such litigation matters and claims cannot be predicted with certainty, we believe that the final outcome of any such claims and proceedings will not have a material adverse impact on the Company’s financial position, liquidity, or results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Price Range of Common Stock

Our common stock is traded on the NASDAQ Capital Market under the symbol "OVLY." The following table sets forth the high and low closing bid prices (which reflect prices between dealers and do not include retail markup, markdown or commission and may not represent actual transactions) for the two calendar years ended December 31, 2015 and 2014, respectively. From time to time, during the periods indicated, trading activity in our common stock was infrequent. The source of the quotes is The NASDAQ Stock Market, LLC.

	Closing Sale Price	
For Calendar Quarter Ended	**High**	**Low**
March 31, 2014	$12.48	$8.25
June 30, 2014	$10.22	$9.42
September 30, 2014	$10.50	$9.44
December 31, 2014	$10.75	$9.47
March 31, 2015	$11.75	$8.87
June 30, 2015	$10.50	$8.99
September 30, 2015	$10.40	$9.29
December 31, 2015	$11.35	$9.26

On March 18, 2016, the closing price of our common stock was $9.61 per share; and there were approximately 422 shareholders of record of the common stock and 8,088,155 outstanding shares of common stock.

Dividends

Our ability to pay any cash dividends will depend not only upon our earnings during a specified period, but also on our meeting certain capital requirements.

Dividends the Company declares are subject to the restrictions set forth in the California General Corporation Law (the “Corporation Law”). The Corporation Law provides that a corporation may make a distribution to its shareholders if the corporation’s retained earnings equal at least the amount of the proposed distribution. The Corporation Law also provides that, in the event that sufficient retained earnings are not available for the proposed distribution, a corporation may nevertheless make a distribution to its shareholders if it meets two conditions, which generally stated are as follows: (i) the corporation’s assets equal at least 1 and 1/4 times its liabilities, and (ii) the corporation’s current assets equal at least its current liabilities or, if the average of the corporation’s earnings before taxes on income and before interest expenses for the two preceding fiscal years was less than the average of the corporation’s interest expenses for such fiscal years, then the corporation’s current assets must equal at least 1 and 1/4 times its current liabilities.

Additionally, the Federal Reserve Board has authority to limit the payment of dividends by bank holding companies, such as the Company, in certain circumstances, requiring, among other things, a holding company to consult with the Federal Reserve Board prior to payment of a dividend if the company does not have sufficient recent earnings in excess of the proposed dividend.

The principal source of funds from which the Company may pay dividends is the receipt of dividends from the Bank. The availability of dividends from the Bank is limited by various statutes and regulations. The Bank is subject first to corporate restrictions on its ability to pay dividends. Further, the Bank may not pay a dividend if it would be undercapitalized after the dividend payment is made. The payment of cash dividends by the Bank is subject to restrictions set forth in the California Financial Code (the “Financial Code”). The Financial Code provides that a bank may not make a cash distribution to its shareholders in excess of the lesser of (a) bank’s retained earnings; or (b) bank’s net income for its last three fiscal years, less the amount of any distributions made by the bank or by any majority-owned subsidiary of the bank to the shareholders of the bank during such period. However, a bank may, with the approval of the DBO, make a distribution to its shareholders in an amount not exceeding the greatest of (a) its retained earnings; (b) its net income for its last fiscal year; or (c) its net income for its current fiscal year. In the event that the DBO determines that the shareholders’ equity of a bank is inadequate or that the making of a distribution by the bank would be unsafe or unsound, the DBO may order the bank to refrain from making a proposed distribution. The FDIC may also restrict the payment of dividends if such payment would be deemed unsafe or unsound or if after the payment of such dividends, the bank would be included in one of the “undercapitalized” categories for capital adequacy purposes pursuant to federal law.

While the Federal Reserve Board has no general restriction with respect to the payment of cash dividends by an adequately capitalized bank to its parent holding company, the Federal Reserve Board might, under certain circumstances, place restrictions on the ability of a particular bank to pay dividends based upon peer group averages and the performance and maturity of the particular bank, or object to management fees to be paid by a subsidiary bank to its holding company on the basis that such fees cannot be supported by the value of the services rendered or are not the result of an arm’s length transaction.

Shareholders are entitled to receive dividends only when and if dividends are declared by our Board of Directors. Although we have paid dividends in the past, it is no guarantee that we will pay cash dividends in the future. No dividends were paid for the year ended December 31, 2013. During 2014, two cash dividends were paid, a $0.10 per common share dividend in January and a $0.065 per common share dividend in July. During 2015, two cash dividends were paid, a $0.10 per common share dividend in January and a $0.11 per common share dividend in July.

Equity Compensation Plan Information

The following table provides information as of December 31, 2015 with respect to shares of our common stock that are issued and currently outstanding under the Company’s 1998 Restated Stock Option Plan (the “1998 Restated Stock Option Plan”), and the number of shares that are authorized to be issued under the Company’s 2008 Equity Plan (the “2008 Equity Plan”).

Plan Category	**A** **Number of Securities to be** **Issued Upon Exercise** **of Outstanding Options**	**B** **Weighted Average** **Exercise Price of Outstanding Options**	**C** **Number of Securities** **Remaining Available for** **Future Issuance Under 2008** **Equity Plan (Excluding Securities**

			Reflected in Column A)
Equity Compensation Plans Approved by Shareholders	33,000	$ 12.13	1,312,820
Equity Compensation Plans Not Approved by Shareholders	0	0	0
Total	33,000	$ 12.13	1,312,820

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

Not applicable.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following discussion of financial condition as of December 31, 2015 and 2014 and results of operations for each of the years in the two-year period ended December 31, 2015 should be read in conjunction with our consolidated financial statements and related notes thereto, included in this report. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances.

Forward-Looking Statements

This discussion of financial results includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, (the "1933 Act") and Section 21E of the Securities Exchange Act of 1934, as amended, (the "1934 Act"). Those sections of the 1933 Act and 1934 Act provide a "safe harbor" for forward-looking statements to encourage companies to provide prospective information about their financial performance so long as they provide meaningful, cautionary statements identifying important factors that could cause actual results to differ significantly from projected results.

Our forward-looking statements include descriptions of plans or objectives of Management for future operations, products or services, and forecasts of our revenues, earnings or other measures of economic performance. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include the words "believe," "expect," "intend," "estimate" or words of similar meaning, or future or conditional verbs such as "will," "would," "should," "could" or "may."

Forward-looking statements are based on Management's current expectations regarding economic, legislative, and regulatory issues that may impact our earnings in future periods. A number of factors - many of which are beyond Management's control - could cause future results to vary materially from current Management's expectations. Such factors include, but are not limited to, general economic conditions, the current financial turmoil in the United States and abroad, changes in interest rates, deposit flows, real estate values and industry competition; changes in accounting principles, policies or guidelines; changes in legislation or regulation; and other economic, competitive, governmental, regulatory and technological factors affecting our operations, pricing, products and services. Forward-looking statements speak only as of the date they are made. We do not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made or to reflect the occurrence of unanticipated events.

Introduction

Our continued focus on responsible community banking fundamentals and our strong customer relationships have enabled us to increase our market presence through growth in our loan portfolio which is primarily funded by steady core deposit growth.

As of December 31, 2015, we had approximately $897 million in total assets, $541 million in total gross loans, and $815 million in total deposits. These figures include $79 million in total assets, $43 million in total net loans, and $71 million in total deposits of Mother Lode Bank that were brought in upon the merger of Mother Lode Bank into the Bank.

We believe the following were key indicators of our performance during 2015:

our total assets increased to $897 million at the end of 2015, an increase of 19.7%, from $750 million at the end of 2014. The acquisition of Mother Lode Bank is attributable for $79 million or 53% of the 2015 growth.

our total deposits increased to $815 million at the end of 2015, an increase of 21.7%, from $670 million at the end of 2014. The acquisition of Mother Lode Bank is attributable for $71 million or 49% of the 2015 growth.

our total net loans increased to $530 million at the end of 2015, an increase of 18.8%, from $446 million at the end of 2014. The acquisition of Mother Lode Bank is attributable for $43 million or 51% of the 2015 growth.

net interest income increased $116,000 or 0.5% in 2015 compared to 2014, mainly as a result of growth of our loan and investment portfolios. The acquisition of Mother Lode Bank is attributable for $57,000 or 49% of the 2015 growth.

reversal of provision for loan losses decreased $1.8 million or 93.3% to a reversal of provision of $125,000 compared to $1.9 million in 2014, due to a loan recovery as described below.

our ratio of total non-performing loans to total loans increased to 1.22% at December 31, 2015 from 1.03% at December 31, 2014. Non-performing loans acquired from Mother Lode Bank were 0.62% of the acquired total loans. Management considers that the size of the ratio of non-performing assets to total loans is moderate and manageable, and reserves have been taken appropriately.

total noninterest income increased to $4.1 million in 2015, an increase of 9.1%, from $3.8 million in 2014, which is mainly attributable to our growing deposit account base. The acquisition of Mother Lode Bank is attributable for $7,000 or 2% of the 2015 growth.

total noninterest expense increased from $20.2 million in 2014 to $22.7 million in 2015, primarily due to the merger related expenses of $1.97 million associated with the acquisition of Mother Lode Bank.

These items, as well as other factors, such as the acquisition of Mother Lode Bank, contributed to the decrease in net income for 2015 to $4.91 million from $7.12 million in 2014, which translates into $0.61 per diluted share in 2015 as compared to $0.89 per diluted share in 2014.

Over the past several years, our network of branches and loan production offices have expanded geographically. We currently maintain sixteen full-service offices. We intend to continue our growth strategy in future years through the opening of additional branches and loan production offices as our needs and resources permit.

2016 Outlook

As we begin our strategic business plan for 2016, we remained focused on relationship based expansion throughout our market area. We will continue to focus on increasing our loan-to-deposit ratio to expand our net interest margin, while attempting to control expenses and credit losses.

The decline of market interest rates to historic lows over the past years, has had a negative impact on net interest income despite the slight increase recognized during 2015, which was primarily due to growth of earning assets. We expect the low interest rate environment could have a similar impact in 2016 unless interest rates begin to increase significantly. The potential compression of net interest income and net interest margin would be a likely outcome if interest rates remain static or decline, given that our balance sheet is asset sensitive to interest rate changes primarily due to the number of variable rate loans and a high level of interest-earning cash balances. This could in turn result in further decrease on the yield of earning assets compared to the cost of deposits and other funds, which have already reached a floor which cannot reasonably be further reduced.

Recent trends in our economy prompted the FOMC to increase the target federal funds by 0.25% in December 2015 and it’s likely that interest rates may continue to rise during 2016 at a moderate pace. Given our asset sensitive balance sheet, we expect a favorable impact on net interest income from interest rate increases. If we experience an increase in our yield on earnings assets we could then determine to increase the interest rates we pay on our deposit accounts or change our promotional or other interest rates on new deposits in marketing activation programs to attempt to achieve a certain net interest margin. In light of the current economic environment, it may not be possible to manage the interest margin in this manner, as competitive pressures may dictate that we increase deposit rates at a faster rate than the earning assets increase, thereby offsetting any gains to the net interest margin. Any increases in the rates we charge on accounts could have an effect on our efforts to attract new customers and grow loans, particularly with the continuing competition in the commercial and consumer lending industry. The economies and real estate markets in our primary market areas will continue to be significant determinants of the quality of our assets in future periods and, thus, our results of operations, liquidity and financial condition. While published economic data indicates that the downturn is behind us, it is not clear at what speed the economy will recover.

For 2016, management remains focused on the above challenges and opportunities and other factors affecting the business similar to the factors driving 2015 results as discussed in this section.

Holding Company

Effective July 3, 2008, Oak Valley Community Bank became a subsidiary of Oak Valley Bancorp, a newly established bank holding company. Oak Valley Bancorp operates Oak Valley Community Bank as a community bank in the general commercial banking business, with our primary market encompassing the California Central Valley around Oakdale and Modesto, and the Eastern Sierras. As such, unless otherwise noted, all references are about Oak Valley Bancorp.

In the bank holding company reorganization, all outstanding shares of common stock of the Bank were exchanged for an equal number of shares of common stock of Oak Valley Bancorp, which now owns the Bank as its wholly-owned subsidiary. Management believes that operating the Bank within a holding company structure, among other things:

- provides greater operating flexibility than is currently enjoyed by us.
- facilitates the acquisition of related businesses as opportunities arise.
- improves our ability to diversify.
- enhances our ability to remain competitive in the future with other companies in the financial services industry that are organized in a holding company structure.
- enhances our ability to raise capital to support growth.

The financial statements and discussion thereof contained in this report for periods subsequent to the reorganization relate to the consolidated financial statements of Oak Valley Bancorp.

Critical Accounting Policies

Critical accounting policies are those that are both most important to the portrayal of our financial condition and results of operations and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

The discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that effect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions. In addition, GAAP itself may change from one previously acceptable method to another method, although the economics of our transactions would be the same.

Management has determined the following accounting policies to be critical:

Asset Impairment Judgments

Certain of our assets are carried in our consolidated balance sheets at fair value or at the lower of cost or fair value. Valuation allowances are established when necessary to recognize impairment of such assets. We periodically perform analyses to test for impairment of various assets. In addition to our impairment analyses related to loans, another significant impairment analysis relates to other than temporary declines in the value of our securities.

Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired and are carried at fair value or below. Appraisals are done periodically on impaired loans and if required an allowance is established based on the fair value of collateral less the cost related to liquidation of the collateral. In some circumstances, an impaired loan may be charged off to bring the carrying value to fair value.

Other real estate assets (“OREO”) acquired through, or in lieu of, foreclosure are held-for-sale and are initially recorded at the lower of cost or fair value, less selling costs. Any write-downs to fair value at the time of transfer to OREO are charged to the allowance for loan losses, subsequent to foreclosure. Appraisals or evaluations are then done periodically thereafter charging any additional write-downs or valuation allowances to the appropriate expense accounts.

Net realizable value of the underlying collateral is the fair value of the collateral less estimated selling costs and any prior liens. Appraisals, recent comparable sales, offers and listing prices are factored in when valuing the collateral. We review and verify the qualifications and licenses of the certified general appraisers used for appraising commercial properties or certified residential appraisers for residential properties. Real estate appraisals may utilize a combination of approaches including replacement cost, sales comparison and the income approach. Comparable sales and income data are analyzed by the appraisers and adjusted to reflect differences between them and the subject property such as type, leasing status and physical condition. When the appraisals are received, Management reviews the assumptions and methodology utilized in the appraisal, as well as the overall resulting value in conjunction with independent data sources such as recent market data and industry-wide statistics. We generally use a 6% discount for selling costs which is applied to all properties, regardless of size. Appraised values may be adjusted to reflect changes in market conditions that have occurred subsequent to the appraisal date, or for revised estimates regarding the timing or cost of the property sale. These adjustments are based on qualitative judgments made by management on a case-by-case basis.

Our available for sale portfolio is carried at estimated fair value, with any unrealized gains and losses, net of taxes, reported as accumulated other comprehensive income in shareholders' equity. We conduct a periodic review and evaluation of the securities portfolio to determine if the value of any security has declined below its carrying value and whether such decline is other than temporary. If such decline is deemed other than temporary, we would adjust the carrying amount of the security by writing down the security to fair value through a charge to current period income. The fair values of our securities are significantly affected by changes in interest rates.

In general, as interest rates rise, the fair value of fixed-rate securities will decrease; as interest rates fall, the fair value of fixed-rate securities will increase. With significant changes in interest rates, we evaluate our intent and ability to hold the security for a sufficient time to recover the recorded principal balance. Estimated fair values for securities are based on published or securities dealers' market values. Market volatility is unpredictable and may impact such values.

Allowance for Loan Losses

Credit risk is inherent in the business of lending and making commercial loans. Accounting for our allowance for loan losses involves significant judgment and assumptions by management and is based on historical data and management's view of the current economic environment. At least on a quarterly basis, our management reviews the methodology and adequacy of allowance for loan losses and reports its assessment to the Board of Directors for its review and approval.

The allowance for loan losses is an estimate of probable incurred losses with regard to our loans. Our loan loss provision for each period is dependent upon many factors, including loan growth, net charge-offs, changes in the composition of the loans, delinquencies, management's assessment of the quality of the loans, the valuation of problem loans and the general economic conditions in our market area. We base our allowance for loan losses on an estimation of probable losses inherent in our loan portfolio.

Our methodology for assessing loan loss allowances are intended to reduce the differences between estimated and actual losses and involves a detailed analysis of our loan portfolio, in three phases:

the specific review of individual loans,

the segmenting and review of loan pools with similar characteristics, and our judgmental estimate based on various subjective factors:

The first phase of our methodology involves the specific review of individual loans to identify and measure impairment. We evaluate each loan by use of a risk rating system, except for homogeneous loans, such as automobile loans and home mortgages. Specific risk rated loans are deemed impaired if all amounts, including principal and interest, will likely not be collected in accordance with the contractual terms of the related loan agreement. Impairment for commercial and real estate loans is measured either based on the present value of the loan's expected future cash flows or, if collection on the loan is collateral dependent, the estimated fair value of the collateral, less selling and holding costs.

The second phase involves the segmenting of the remainder of the risk rated loan portfolio into groups or pools of loans, together with loans with similar characteristics, for evaluation. We determine the calculated loss ratio to each loan pool based on its historical net losses and benchmark it against the levels of other peer banks.

In the third phase, we consider relevant internal and external factors that may affect the collectability of loan portfolio and each group of loan pool. The factors considered are, but are not limited to:

concentration of credits,

nature and volume of the loan portfolio,

delinquency trends,

non-accrual loan trend,

problem loan trend,

loss and recovery trend,

quality of loan review,

lending and management staff,

lending policies and procedures,

economic and business conditions, and

other external factors.

Our management estimates the probable effect of such conditions based on our judgment, experience and known or anticipated trends. Such estimation may be reflected as an additional allowance to each group of loans, if necessary. Management reviews these conditions with our senior credit officers. To the extent that any of these conditions is evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management's estimate of the effect of such condition may be reflected as a specific allowance applicable to such credit or portfolio segment. Where any of these conditions is not evidenced by a specific, identifiable problem credit or portfolio segment as of the evaluation date, management's evaluation of the inherent loss related to such condition is reflected in the unallocated allowance.

Central to our credit risk management and our assessment of appropriate loss allowance is our loan risk rating system. Under this system, the originating credit officer assigns borrowers an initial risk rating based on a thorough analysis of each borrower's financial capacity in conjunction with industry and economic trends. Approvals are made based upon the amount of inherent credit risk specific to the transaction and are reviewed for appropriateness by senior line and credit administration personnel. Credits are monitored by line and credit administration personnel for deterioration in a borrower's financial condition which may impact the ability of the borrower to perform under the contract. Although management has allocated a portion of the allowance to specific loans, specific loan pools, and off-balance sheet credit exposures (which are reported separately as part of other liabilities), the adequacy of the allowance is considered in its entirety.

It is the policy of management to maintain the allowance for loan losses at a level adequate for risks inherent in the overall loan portfolio, however, the loan portfolio can be adversely affected if the state of California's economic conditions and its real estate market in our general market area were to further deteriorate or weaken. Additionally, further weakness of a prolonged nature in the agricultural and general economy would have a negative impact on the local market. The effect of such economic events, although uncertain and unpredictable at this time, could result in an increase in the levels of nonperforming loans and additional loan losses, which could adversely affect our future growth and profitability. No assurance of the level of predicted credit losses can be given with any certainty.

Non-Accrual Loan Policy

Interest on loans is credited to income as earned and is accrued only if deemed collectible. Accrual of interest is discontinued when a loan is over 90 days delinquent or if management believes that collection is highly uncertain. Generally, payments received on nonaccrual loans are recorded as principal reductions. Interest income is recognized after all principal has been repaid or an improvement in the condition of the loan has occurred that would warrant resumption of interest accruals.

Income Taxes

Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled using the liability method. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

The Company files income tax returns in the U.S. federal jurisdiction, and the state of California. With few exceptions, the Company is no longer subject to U.S. federal or state/local income tax examinations by tax authorities for years before 2011.

Fair Value Measurements

We use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. We base our fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Securities available for sale, derivatives, and loans held for sale, if any, are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record certain assets at fair value on a non-recurring basis, such as certain impaired loans held for investment and securities held to maturity that are other-than-temporarily impaired. These non-recurring fair value adjustments typically involve write-downs of individual assets due to application of lower-of-cost or market accounting.

We have established and documented a process for determining fair value. We maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. Whenever there is no readily available market data, management uses its best estimate and assumptions in determining fair value, but these estimates involve inherent uncertainties and the application of management's judgment. As a result, if other assumptions had been used, our recorded earnings or disclosures could have been materially different from those reflected in these financial statements. For detailed information on our use of fair value measurements and our related valuation methodologies, see Note 16 to the Consolidated Financial Statements in Item 8 of this Form 10-K.

Recently Issued Accounting Standards

In January 2014, the FASB issued ASU No. 2014 – 01, Investments – Equity Method and Joint Ventures (Topic 323), Accounting for Investments in Qualified Affordable Housing Projects. This Update provides guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit. The amendments in this Update permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this Update are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. The adoption of ASU No. 2014-01 did not have a material impact on the Company's consolidated financial statements.

In January 2014, the FASB issued ASU No. 2014 – 04, Receivables – Troubled Debt Restructurings by Creditors. This ASU provides clarification that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The adoption of ASU No. 2014-04 did not have a material impact on the Company's consolidated financial statements.

In August 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-14 *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40), Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure.* This update addresses classification of government-guaranteed mortgage loans, including those where guarantees are offered by the Federal Housing Administration (“FHA”), the U.S. Department of Housing and Urban Development (“HUD”), and the U.S. Department of Veterans Affairs (“VA”). Although current accounting guidance stipulates proper measurement and classification in situations where a creditor obtains from a debtor, assets in satisfaction of a receivable (such as through foreclosure), current guidance does not specify how to measure and classify foreclosed mortgage loans that are government-guaranteed. Under the provisions of this update, a creditor would derecognize a mortgage loan that has been foreclosed upon, and recognize a separate receivable if the following conditions are met: (1) the loan has a government guarantee that is not separable from the loan before foreclosure, (2) At the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim, (3) At the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. The amendments within this update are effective for annual and interim periods beginning after December 15, 2014. The adoption of ASU No. 2014-14 did not have a material impact on the Company's consolidated financial statements.

In September, 2015, the FASB issued ASU No. 2015-16, Simplifying the Accounting for Measurement Period Adjustments (Topic 805). This ASU eliminates the requirement to restate prior period financial statements for measurement period adjustments to assets acquired and liabilities assumed in a business combination. The new guidance under this update requires the cumulative impact of measurement period adjustments be recognized in the period the adjustment is determined. This update does not change what constitutes a measurement period adjustment, nor does it change the length of the measurement period. The new standard is effective for interim annual periods beginning after December 15, 2015 and should be applied prospectively to measurement period adjustments that occur after the effective date. The adoption of this update did not have a material impact on the Company’s consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in this ASU make improvements to GAAP related to financial instruments that include the following as applicable to us.

Equity investments, except for those accounted for under the equity method of accounting or those that result in consolidation of the investee, are required to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.

Simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment - if impairment exists, this requires measuring the investment at fair value.

Eliminates the requirement for public companies to disclose the method(s) and significant assumptions used to estimate the fair value that is currently required to be disclosed for financial instruments measured at amortized cost on the balance sheet.

Public companies will be required to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes.

Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements.

The reporting entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

ASU 2016-01 is effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. This ASU will impact our financial statement disclosures, however, we do not expect this ASU to have a material impact on our financial condition or results of operations.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). This ASU was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities, including leases classified as operating leases under previous GAAP, on the balance sheet and requiring additional disclosures of key information about leasing arrangements. ASU 2016-02 is effective for annual periods, including interim periods within those annual periods beginning after December 15, 2018 and requires a modified retrospective approach to adoption. Early application of the amendments is permitted. We are currently evaluating the provisions of this ASU and will be monitoring developments and additional guidance to determine the potential outcome the amendments will have on our financial condition and results of operations.

Results of Operations

The Company earns income from two primary sources. The first is net interest income, which is interest income generated by earning assets less interest expense on interest-bearing liabilities. The second is noninterest income, which primarily consists of deposit service charges and fees, the increase in cash surrender value of life insurance and mortgage commissions. The majority of the Company's noninterest expenses are operating costs that relate to providing a full range of banking services to our customers.

Overview

We recorded net income for the year ended December 31, 2015 of $4,908,000 or $0.61 per diluted share compared to $7,122,000 or $0.89 per diluted share for the year ended December 31, 2014. The decrease in net income for the year ended December 31, 2015 was primarily due to an increase of $2,441,000 in non-interest expense, mainly from the $1,971,000 in merger related expenses and an increase in overhead from the new Tracy and Sonora branches that were opened in December 2014 and December 2015, respectively. Contributing to the net income decrease in 2015 was a decrease of $1,752,000 in reversals of provision for loan losses. Partially offsetting these factors was an increase of $116,000 in net interest income, an increase in non-interest income of $343,000 and a decrease in income tax provision of $1,520,000 due to lower levels of pre-tax earnings.

Highlights of the financial results are presented in the following table:

(Dollars in thousands, except per share data)	As of and for the years ended December 31, 2015	2014	2013
For the period:			
Net income available to common shareholders	$4,908	$7,122	$5,819
Net income per common share:			
Basic	$0.61	$0.90	$0.75
Diluted	$0.61	$0.89	$0.74
Return on average common equity	6.41 %	10.07 %	9.07 %
Return on average assets	0.63 %	1.03 %	0.90 %
Common stock dividend payout ratio of earnings during the period	34.54 %	18.54 %	13.51 %
Efficiency ratio	68.07 %	67.03 %	65.65 %
At period end:			
Book value per common share	$9.69	$9.29	$8.14
Total assets	$897,038	$749,665	$671,853
Total gross loans	$541,032	$454,471	$419,438
Total deposits	$814,691	$669,581	$602,633
Net loan-to-deposit ratio	65.10 %	66.68 %	68.23 %

Net Interest Income and Net Interest Margin

Our primary source of revenue is net interest income, which is the difference between interest and fees derived from earning assets and interest paid on liabilities obtained to fund those assets. Our net interest income is affected by changes in the level and mix of interest-earning assets and interest- bearing liabilities, referred to as volume changes. Our net interest income is also affected by changes in the yields earned on assets and rates paid on liabilities, referred to as rate changes. Interest rates charged on our loans are affected principally by the demand for such loans, the supply of money available for lending purposes and competitive factors. Those factors are, in turn, affected by general economic conditions and other factors beyond our control, such as federal economic policies, the general supply of money in the economy, legislative tax policies, the governmental budgetary matters, and the actions of the Federal Reserve Board.

For a detailed analysis of interest income and interest expense, see the "Average Balance Sheets" and the "Rate/Volume Analysis" below.

(Dollars in Thousands)	Distribution, Yield and Rate Analysis of Net Income For the Years Ended December 31, 2015			2014		
	Average Balance	Interest Income/ Expense	Avg Rate/ Yield	Average Balance	Interest Income/ Expense	Avg Rate/ Yield
Assets:						
Earning assets:						
Gross loans (1) (2)	$466,509	$22,055	4.73 %	$430,448	$22,018	5.12 %
Securities of U.S. government agencies	8,287	141	1.70 %	11,139	212	1.90 %
Other investment securities (2)	117,756	4,402	3.74 %	110,261	4,248	3.85 %
Federal funds sold	13,842	34	0.25 %	16,426	38	0.23 %
Interest-earning deposits	111,790	304	0.27 %	65,377	179	0.27 %
Total interest-earning assets	718,184	26,936	3.75 %	633,651	26,695	4.21 %
Total noninterest earning assets	57,356			59,367		
Total Assets	$775,540			$693,018		
Liabilities and Shareholders' Equity:						
Interest-bearing liabilities:						
Business Interest DDA	20,587	8	0.04 %	16,338	7	0.04 %
Money market deposits	266,856	283	0.11 %	238,736	277	0.12 %
NOW deposits	112,472	77	0.07 %	97,080	69	0.07 %
Savings deposits	48,130	55	0.11 %	39,820	43	0.11 %
Time certificates over $250,000	14,564	26	0.18 %	10,141	32	0.32 %
Other time deposits	32,936	166	0.50 %	40,831	219	0.54 %
Other borrowings	12	0	0.00 %	2	0	0.08 %
Total interest-bearing liabilities	495,557	615	0.12 %	442,948	647	0.15 %
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	199,446			175,329		
Other liabilities	3,999			4,047		
Total noninterest-bearing liabilities	203,445			179,376		
Shareholders' equity	76,538			70,694		
Total liabilities and shareholders' equity	$775,540			$693,018		
Net interest income		$26,321			$26,048	
Net interest spread (3)			3.63 %			4.06 %
Net interest margin (4)			3.66 %			4.11 %

(1) Loan fees have been included in the calculation of interest income.
(2)

Yields on municipal securities and loans have been adjusted to their fully-taxable equivalents (FTE), based on a federal marginal tax rate of 34.0%.

(3) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

(4) Represents net interest income as a percentage of average interest-earning assets.

Net interest income, on a fully tax equivalent basis (FTE), increased $273,000 or 1.1% to $26,321,000 for the year ended December 31, 2015, compared to $26,048,000 in 2014. Net interest spread and net interest margin were 3.63% and 3.66%, respectively, for the year ended December 31, 2015, compared to 4.06% and 4.11%, respectively, for the year ended December 31, 2014. Overall, the Company has experienced net interest margin compression since the economic downturn in 2008 for several reasons: 1) deposit interest rates have essentially reached a threshold from which they cannot reasonably be further reduced, 2) competition in the lending market has driven new loan rates down, 3) loan and investment portfolio yields continue to decrease due to contractual repricing and 4) deposit growth has out-paced loan growth and the elevated interest-bearing cash balances, which yield approximately 0.25%, have compressed our net interest margin.

The cost of funds on interest-bearing liabilities decreased 3 basis points in 2015 compared to 2014, due to moderate rate reductions across all deposit products and a shift from high cost CDs into demand deposit and savings accounts. In addition, average non-interest-bearing demand deposit balances increased by $24,117,000 in 2015 compared to 2014, further reducing our cost of funds.

Our earning asset yield decreased 46 basis points in 2015 compared to 2014. The yield on loans recognized a reduction of 39 basis points for 2015 compared to 2014, which was minimized due to the significant portion of our loans that are at their contractual rate floors. In addition, the large majority of our variable loans are tied to the U.S. Treasury Constant Maturity Indices with repricing intervals between one and five years. This decrease in loan yield was primarily a result of competitive pressure on the pricing of new loan fundings. The drop in loan yield was offset by deploying a portion of the low yielding cash equivalent balances into loan and investment balances which recognized increased average balances of $36,061,000 and $4,643,000, respectively, in 2015 as compared to 2014.

Changes in volume resulted in an increase in net interest income (FTE) of $2,174,000 for the year of 2015 compared to the year 2014, and changes in interest rates and the mix resulted in a decrease in net interest income (FTE) of $1,901,000 for the year 2015 versus the year 2014. Management closely monitors both total net interest income and the net interest margin.

Market rates are in part based on the Federal Reserve Open Market Committee ("FOMC") target Federal funds interest rate (the interest rate banks charge each other for short-term borrowings). The change in the Federal funds sold and purchased rates is the result of target rate changes implemented by the FOMC. In 2008, there were seven downward adjustments to the target rate totaling 325 basis points, bringing the target interest rate to a historic low with a range of 0% to 0.25% where it remained until December 2015 when the FOMC increased by 0.25% to a range of 0.25% to 0.50%.

Rate/Volume Analysis

The following table below sets forth certain information regarding changes in interest income and interest expense of the Company for the periods indicated. For each category of earning assets and interest bearing liabilities, information is provided on changes attributable to (i) changes in volume (change in average volume multiplied by old rate); and (ii) changes in rates (change in rate multiplied by old average volume). Changes in rate/volume (change in rate multiplied by the change in volume) have been allocated to the changes due to volume and rate in proportion to the absolute value of the changes due to volume and rate prior to the allocation.

Rate/Volume Analysis of Net Interest Income

(Dollars in Thousands)	For the Year Ended December 31, 2015 vs. 2014 Increases (Decreases) Due to Change In			For the Year Ended December 31, 2014 vs. 2013 Increases (Decreases) Due to Change In		
	Volume	**Rate**	**Total**	**Volume**	**Rate**	**Total**
Interest income:						
Net loans (1)	$1,845	$(1,808)	$37	$1,807	$(1,202)	$605
Securities of U.S. government agencies	(54)	(17)	(71)	(24)	35	11
Other Investment securities	289	(135)	154	324	63	387
Federal funds sold	(6)	2	(4)	13	0	13
Interest-earning deposits	127	(2)	125	(38)	6	(32)
Total interest income	2,201	(1,960)	241	2,082	(1,098)	984
Interest expense:						
Business Interest DDA	$2	$(1)	$1	$4	$(10)	$(6)
Money market deposits	33	(27)	6	0	(47)	(47)
NOW deposits	11	(3)	8	14	(28)	(14)
Savings deposits	9	3	12	7	(15)	(8)
Time certificates over $250,000	14	(20)	(6)	2	(15)	(13)
Other time deposits	(42)	(11)	(53)	(34)	(59)	(93)
Other borrowings	0	0	0	0	0	0
Total interest expense	27	(59)	(32)	(7)	(174)	(181)
Change in net interest income	$2,174	$(1,901)	$273	$2,089	$(924)	$1,165

(1) Loan fees have been included in the calculation of interest income.

Provision for Loan Losses

Credit risk is inherent in the business of making loans. The Company establishes an allowance for loan losses through charges to earnings, which are shown in the consolidated statements of income as the provision for loan losses. Specifically identifiable and quantifiable losses are promptly charged off against the allowance. The Company maintains the allowance for loan losses at a level that it considers to be adequate to provide for credit losses inherent in its loan portfolio. Management determines the level of the allowance by performing a quarterly analysis that considers concentrations of credit, past loss experience, current economic conditions, the amount and composition of the loan portfolio (including nonperforming and potential problem loans), estimated fair value of underlying collateral, and other information relevant to assessing the risk of loss inherent in the loan portfolio such as for example loan growth, net charge-offs, changes in the composition of the loan portfolio, and delinquencies. As a result of management’s analysis, a range of the potential amount of the allowance for loan losses is determined.

Due to a sale of the collateral property and subsequent pay off of an impaired loan and noted trends of improved credit quality, the Company recorded a reversal loan loss provisions of $125,000 for the year ended December 31, 2015 as compared to reversal of loan loss provisions of $1,877,000 resulting from a loan settlement of $2,923,000 for the year ended December 31, 2014. Nonperforming loans were $5,816,000 at December 31, 2015 and $4,700,000 at December 31, 2014, or 1.07% and 1.03%, respectively, of total loans. Nonperforming loans are primarily in nonperforming real estate construction and development loans. The allowance for loan losses was $7,356,000 and $7,534,000 at December 31, 2015 and 2014, or 1.36% and 1.66%, respectively, of total loans. The decrease in the allowance for loan loasses as a percentage of total loans is due to the $42,831,000 in loans acquired from Mother Lode Bank that are marked to fair value according to purchase accounting rules, and therefore do not require an allowance for loan loss at the time of acquisition. Net charge-offs totaled $53,000 in 2015, compared to net recoveries of $1,752,000 in 2014. The increase of the net charge-offs in 2015 compared to 2014 was due to the $2,923,000 loan settlement which resulted in the recovery of $1,877,000 in 2014.

The Company will continue to monitor the adequacy of the allowance for loan losses and make additions to the allowance in accordance with the analysis referred to above. Because of uncertainties inherent in estimating the appropriate level of the allowance for loan losses, actual results may differ from management's estimate of credit losses and the related allowance.

Noninterest Income

Noninterest income was $4,107,000 for the year ended December 31, 2015, compared to $3,764,000 for the year 2014. In 2015, other income increased by $465,000, which was attributable to the elimination of our checking rewards program in December 2014, increases in FHLB stock dividends and debit card interchange fee income of $195,000, $137,000 and $96,000, respectively, compared to 2014. Mortgage commissions have decreased by $9,000 or 5.7% for the year 2015, as compared to 2014, as a result of the slow demand for home purchases and refinancing. Service charge income decreased to $1,240,000 for the year 2015 compared to $1,346,000 for the year 2014, as a result of the decrease in overdraft activity and corresponding overdraft fees, despite an increase in the aggregate number of transaction deposit accounts. Earnings on cash surrender value of life insurance and gains on called securities were relatively flat compared to the prior year, as there were no changes to life insurance policies and we recognized comparable one-time gains from called securities. The Mother Lode Bank had a minimal impact of $7,000 on the non-interest income recognized in 2015, as the Company owned the acquired loans and deposits for the final eight days of 2015. The Company continues to evaluate its deposit product offerings with the intention of continuing to expand its offerings to the consumer and business depositors.

Noninterest Income

(Dollars in thousands)

For the Years Ended December 31,

	2015 (Amount)	(%)	2014 (Amount)	(%)
Service charges on deposit accounts	$1,240	30.2 %	$1,346	35.8 %
Earnings on cash surrender value of life insurance	429	10.5 %	433	11.5 %
Mortgage commissions	148	3.6 %	157	4.2 %
Gains on called securities	206	5.0 %	209	5.5 %
Other income	2,084	50.7 %	1,619	43.0 %
Total	$4,107	100.0%	$3,764	100.0%
Average assets	$775,540		$693,018	
Noninterest income as a % of average assets		0.5 %		0.5 %

Noninterest Expense

The following table sets forth a summary of noninterest expenses for the periods indicated:

Noninterest Expense

(Dollars in thousands)

	For the Years Ended December 31,			
	2015		**2014**	
	(Amount)	**(%)**	**(Amount)**	**(%)**
Salaries and employee benefits	$11,717	51.7 %	$11,120	55.0 %
Occupancy expenses	3,009	13.3 %	2,902	14.3 %
Data processing fees	1,466	6.5 %	1,336	6.6 %
Regulatory assessments (FDIC & DBO)	506	2.2 %	459	2.3 %
Other operating expenses	5,977	26.3 %	4,417	21.8 %
Total	$22,675	100.0%	$20,234	100.0%
Average assets	$775,540		$693,018	
Noninterest expenses as a % of average assets		2.9 %		2.9 %

Noninterest expense was $22,675,000 for the year ended December 31, 2015, an increase of $2,441,000 or 12.1% compared to $20,234,000 for the year ended 2014. The acquisition of Mother Lode Bank resulted in merger related expenses of $1,971,000 recorded in 2015.

Data processing costs increased in 2015 over 2014 by $130,000, reflecting the additional costs related to the increased number of deposit accounts and the expansion of our products and services. We expect higher data processing costs in 2016 as a result of the servicing costs on the acquired deposits and loans from Mother Lode Bank, but we anticipate cost efficiencies to be gained upon the completion of the data systems conversion scheduled for the second quarter of 2016.

Other operating expenses increased in 2015 by $1,560,000 compared to 2014, primarily due to the $1,971,000 in one-time merger related expenses associated with the Mother Lode Bank acquisition. We expect our core operating expenses to increase in 2016 as we continue to integrate the operations of Mother Lode Bank into those of the Bank.

FDIC and DBO (California Department of Business Oversight) regulatory assessments increased by $47,000 to $506,000 in 2015 compared to $459,000 in 2014. The initial base assessment rate for financial institutions varies based on the overall risk profile of the institution as defined by the FDIC. Our risk profile and corresponding assessment rate has remained stable, however the increase in 2015 is the result of the higher deposit balances in 2015, as the FDIC assessment rates are applied to average quarterly total liabilities as the primary basis. We expect further increases in 2016 due to the cost to insure the acquired deposits from Mother Lode Bank.

Salaries and employee benefits increased by $597,000 in 2015 to $11,717,000 compared to the prior year. To support loan and deposit growth and continue our emphasis on superior customer service, we increased our full-time equivalent staff by 10 as of December 31, 2015 compared to last year, which resulted in increased salary expense and group medical insurance benefits. Much of this increase was due to the impact of the Tracy branch opened in December 2014, as well as the added cost of the second Sonora branch opened in December 2015. The staffing increase was a result of the nine employees that were hired from Mother Lode Bank, which we expect will result in higher expenses in 2016.

Occupancy expense realized an increase of $107,000 in 2015 compared to the prior year, primarily from rent and other overhead expenses from the new Tracy and Sonora branches. The Mother Lode acquisition will have minimal impact on occupancy expense in 2016, as both acquired branches were closed in January 2016.

Management anticipates that noninterest expense will continue to increase as we continue to grow, even though management also estimates that the Company’s administration as currently set up may be scalable to handle a larger deposit base of up to around $1B in deposits. However, management remains committed to cost-control and efficiency, and we expect to keep these increases to a minimum relative to growth.

Provision for Income Taxes

We reported a provision for income taxes of $2,054,000 and $3,574,000 for the years 2015 and 2014, respectively. The effective income tax rate on income from continuing operations was 29.5% for the year ended December 31, 2015 compared to 33.4% for the year 2014. These provisions reflect accruals for taxes at the applicable rates for federal income tax and California franchise tax based upon reported pre-tax income, and adjusted for the effects of all permanent differences between income for tax and financial reporting purposes (such as earnings on qualified municipal securities, BOLI and certain tax-exempt loans). The disparity between the effective tax rates in 2015 as compared to 2014 is primarily due to tax credits from California Enterprise Zones and low income housing projects as well as tax free-income on loans within these enterprise zones and municipal securities and loans that comprise a larger proportion of pre-tax income in 2015 as compared to 2014. We have not been subject to an alternative minimum tax ("AMT") during these periods.

Financial Condition

The Company's total assets were $897,038,000 at December 31, 2015 compared to $749,665,000 at December 31, 2014, an increase of $147,373,000 or 19.7%. Net loans increased $83,902,000, investments increased $10,269,000, bank premises and equipment increased $211,000 and interest receivable and other assets increased $5,494,000, while cash and cash equivalents increased $46,315,000 for the year ended December 31, 2015 as compared to December 31, 2014. Included in these balance sheet growth totals was the acquisition of Mother Lode Bank which added $78,717,000 in assets, $42,831,000 in net loans, $23,500,000 in cash and $4,051,000 in interest receivable and other assets.

Loans gross of the allowance for loan losses and deferred fees were $541,032,000 at December 31, 2015, compared to $454,471,000 at December 31, 2014, an increase of $86,561,000 or 19.1%. The increase was primarily due to an increase of $64,649,000 or 18.0% in commercial real estate loans, an increase of $9,725,000 or 18.0% in commercial and industrial loans, an increase of $7,093,000 or 27.0% in consumer loans and consumer residential loans and an increase of $5,094,000 or 32.3% in agriculture loans. Included in these growth totals is $45,962,000 in gross loans acquired from Mother Lode Bank. The composition of the loan portfolio categories remained relatively unchanged as a percentage of total loans, with commercial real estate comprising 78% and 79% of the loan portfolio at December 31, 2015 and 2014, respectively.

Deposits increased $145,110,000 or 21.7% to $814,691,000 at December 31, 2015 compared to $669,581,000 at December 31, 2014. Time deposits increased by $2,178,000, while Demand, NOW, Money Market and Savings increased by $53,410,000, $22,300,000, $35,007,000 and $32,215,000, respectively, as of December 31, 2015 as compared to December 31, 2014. Included in these growth totals is $71,125,000 in total deposits acquired from

Mother Lode Bank.

There were no short-term borrowing or long-term debt outstanding balances at December 31, 2015 and 2014. The Company uses short-term borrowings, primarily short-term FHLB advances, to fund short-term liquidity needs and manage net interest margin. Equity increased $3,222,000 or 4.3% to $78,263,000 at December 31, 2015, compared to $75,041,000 at December 31, 2014. The Company did not issue any stock to Mother Lode Bank shareholders as it was paid 100% in cash, and therefore there was no impact to equity other than the merger related expenses and exclusions of goodwill and intangibles, which are excluded from tangible equity.

Investment Activities

Investments are a key source of interest income. Management of our investment portfolio is set in accordance with strategies developed and overseen by our Investment Committee. Investment balances, including cash equivalents and interest-bearing deposits in other financial institutions, are subject to change over time based on our asset/liability funding needs and interest rate risk management objectives. Our liquidity levels take into consideration anticipated future cash flows and all available sources of credits and are maintained at levels management believes are appropriate to assure future flexibility in meeting anticipated funding needs.

Cash Equivalents and Interest-bearing Deposits in other Financial Institutions

The Company holds federal funds sold, unpledged available-for-sale securities and salable government guaranteed loans to help meet liquidity requirements and provide temporary holdings until the funds can be otherwise deployed or invested. As of December 31, 2015, and 2014, we had $15,825,000 and $12,210,000, respectively, in federal funds sold.

Investment Securities

Management of our investment securities portfolio focuses on providing an adequate level of liquidity and establishing an interest rate-sensitive position, while earning an adequate level of investment income without taking undue risk. Investment securities that we intend to hold until maturity are classified as held-to-maturity securities, and all other investment securities are classified as available-for-sale. Currently, all of our investment securities are classified as available-for-sale. The carrying values of available-for-sale investment securities are adjusted for unrealized gains or losses as a valuation allowance and any gain or loss is reported on an after-tax basis as a component of other comprehensive income.

Our investment securities holdings increased by $10,269,000, or 8.5%, to $131,546,000 at December 31, 2015, compared to holdings of $121,277,000 at December 31, 2014. Total investment securities as a percentage of total assets decreased to 14.7% as of December 31, 2015 compared to 16.2% at December 31, 2014. As of December 31, 2015, $65,902,000 of the investment securities were pledged to secure public deposits.

As of December 31, 2015, the total unrealized loss on securities that were in a loss position for less than 12 continuous months was $352,000 with an aggregate fair value of $33,307,000. The total unrealized loss on securities that were in a loss position for greater than 12 continuous months was $433,000 with an aggregate fair value of $15,349,000.

The following table summarizes the book value and fair value and distribution of our investment securities as of the dates indicated:

Investment Securities Portfolio

	December 31, 2015		**December 31, 2014**		**December 31, 2013**	
Dollars in Thousands	**Amortized Cost**	**Market Value**	**Amortized Cost**	**Market Value**	**Amortized Cost**	**Market Value**
Available-for-Sale:						
U.S. agencies	$31,815	$32,868	$40,316	$41,930	$52,540	$53,116
Collateralized mortgage obligations	2,729	2,719	6,927	7,072	9,580	9,781

Municipal securities	66,535	68,586	49,396	50,897	42,304	40,269
SBA Pools	811	806	895	892	1,088	1,081
Corporate debt	13,497	13,420	6,726	6,804	4,697	4,825
Asset backed Securities	10,321	10,138	10,766	10,710	5,858	5,856
Mutual fund	3,172	3,009	3,077	2,972	2,975	2,818
Total investment securities	$128,880	$131,546	$118,103	$121,277	$119,042	$117,746

At December 31, 2015, there was one U.S. agency, one collateralized mortgage obligation, 6 municipalities, two SBA pools, three asset backed security, and one mutual fund that comprised the total securities in an unrealized loss position for greater than 12 months and 4 U.S. agencies, 9 municipalities, seven corporate debts, and three asset backed securities that make up the total securities in a loss position for less than 12 months. 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. This evaluation encompasses various factors including, the nature of the investment, the cause of the impairment, the severity and duration of the impairment, credit ratings and other credit related factors such as third party guarantees and volatility of the security's fair value. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due primarily to interest rate changes and the Company does not intend to sell the securities and it is not likely that we will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security. As of December 31, 2015, we did not have any investment securities that constituted 10% or more of the stockholders' equity of any third party issuer.

The following table summarizes the maturity and repricing schedule of our investment securities at their amortized cost and their weighted average yields at December 31, 2015:

Investment Maturities and Repricing Schedule

(Dollars in Thousands)	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years		Total	
	Amount	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**
Available-for-sale:										
U.S. agencies	$4,999	1.02 %	$8,140	4.24 %	$1,648	3.56 %	$17,028	2.75 %	$31,815	2.90 %
Collateralized mortgage obligations	0	0.00 %	0	0.00 %	0	0.00 %	2,729	2.06 %	2,729	2.06 %
Municipalities	2,524	5.30 %	27,841	2.57 %	32,037	2.97 %	4,133	3.93 %	66,535	2.95 %
SBA Pools	0	0.00 %	0	0.00 %	0	0.00 %	811	0.58 %	811	0.58 %
Corporate debt	2,000	2.24 %	4,172	2.36 %	4,825	2.58 %	2,500	4.00 %	13,497	2.72 %
Asset Backed Securities	0	0.00 %	0	0.00 %	9,869	2.33 %	452	1.42 %	10,321	2.29 %
Mutual Fund	0	0.00 %	0	0.00 %	0	0.00 %	3,172	0.00 %	3,172	0.00 %
Total Investment Securities	$9,523	1.94 %	$40,153	2.89 %	$48,379	2.08 %	$30,825	2.58 %	$128,880	2.44 %

Yields in the above table have not been adjusted to a fully tax equivalent basis. Securities are reported at the earliest possible call, repricing or maturity date.

Loans

The following table sets forth the amount of total loans outstanding (excluding unearned income) and the percentage distributions in each category, as of the dates indicated.

(Dollars in Thousands)	YEARS ENDED DECEMBER 31,				
	2015	**2014**	**2013**	**2012**	**2011**
Commercial real estate	$423,047	$358,398	$332,874	$316,075	$330,045
Commercial and industrial	63,776	54,051	48,787	36,529	32,018
Consumer	774	805	883	1,096	1,213
Consumer residential	32,588	25,464	25,623	25,659	23,871

Agriculture	20,847	15,753	11,272	11,628	9,056
Unearned income	(3,282)	(446)	(624)	(600)	(634)
Total Loans, net of unearned income	$537,750	$454,025	$418,815	$390,387	$395,569
Participation loans sold and serviced by the Bank	$19,848	$16,243	$11,733	$8,045	$7,929
Commercial real estate	78.7 %	78.9 %	79.5 %	80.9 %	83.5 %
Commercial and industrial	11.9 %	11.9 %	11.6 %	9.4 %	8.1 %
Consumer	0.1 %	0.2 %	0.2 %	0.3 %	0.3 %
Consumer residential	6.1 %	5.6 %	6.1 %	6.6 %	6.0 %
Agriculture	3.9 %	3.5 %	2.7 %	3.0 %	2.3 %
Unearned income	-0.6 %	-0.1 %	-0.1 %	-0.2 %	-0.2 %
Total Loans, net of unearned income	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %

Commercial real estate loans increased $64,649,000 in 2015 as compared to 2014, as a result of the increased demand by qualified borrowers in our serving area. The acquisition of Mother Lode Bank was attributable for $22,089,000 of the commercial real estate loan growth. Of the commercial real estate loans at December 31, 2015, 44.3% are non-owner occupied and 55.7% are owner occupied. Our commercial real estate loan portfolio is weighted towards term loans for which the primary source of repayment is cash flow from net operating income of the real estate property.

Commercial and industrial loans increased $9,725,000 in 2015 as compared to 2014, as a result of the $13,667,000 in commercial and industrial loans acquired from Mother Lode Bank. We have historically targeted well-established local businesses with strong guarantors that have proven to be resilient in periods of economic stress.

Our residential loan portfolio includes no sub-prime loans, nor is it our normal practice to underwrite loans commonly referred to as "Alt-A mortgages", the characteristics of which are loans lacking full documentation, borrowers having low FICO scores or collateral compositions reflecting high loan-to-value ratios. Substantially all of our residential loans are indexed to Treasury Constant Maturity Rates and have provisions to reset five years after their origination dates.

The following table summarizes our commercial real estate loan portfolio by the geographic location in which the property is located as of December 31, 2015 and 2014:

Commercial Real Estate Loans Outstanding by Geographic Location

(Dollars in Thousands)	**December 31, 2015**			**December 31, 2014**		
Commercial real estate loans by geographic location (County)	**Amount**	**% of Commercial Real Estate Loans**		**Amount**	**% of Commercial Real Estate Loans**	
Stanislaus	$141,694	33.5	%	$142,293	39.7	%
San Joaquin	91,323	21.6	%	67,486	18.8	%
Tuolumne	36,733	8.7	%	24,854	6.9	%
Fresno	19,836	4.7	%	15,566	4.3	%
Merced	13,903	3.3	%	11,384	3.2	%
Alameda	13,030	3.1	%	19,216	5.4	%
Madera	10,233	2.4	%	7,452	2.1	%
Sacramento	9,397	2.2	%	4,348	1.2	%
San Luis Obispo	8,911	2.1	%	9,098	2.5	%

Mono	8,060	1.9	%	8,543	2.4	%
Calaveras	7,474	1.8	%	3,863	1.1	%
Sonoma	6,898	1.6	%	5,988	1.7	%
Inyo	6,511	1.5	%	3,295	0.9	%
Contra Costa	5,756	1.4	%	5,915	1.7	%
Marin	5,681	1.3	%	6,749	1.9	%
Santa Clara	4,328	1.0	%	3,393	0.9	%
Butte	4,319	1.0	%	3,796	1.1	%
Solano	4,168	1.0	%	4,318	1.2	%
Other	24,792	5.9	%	10,841	3.0	%
Total	**$423,047**	**100.0**	**%**	**$358,398**	**100.0**	**%**

Construction and land loans are classified as commercial real estate loans and increased $9.8 million in 2015 as compared to 2014. The table below shows an analysis of construction loans by type and location. Non-owner-occupied land loans of $10.2 million at December 31, 2015 included loans for lands specified for commercial development of $8.8 million and for residential development of $1.4 million, the majority of which are located in Stanislaus County.

Construction and Land Loans Outstanding by Type and Geographic Location

(Dollars in Thousands)	December 31, 2015			December 31, 2014		
Construction and land loans by type	**Amount**	**% of Construction and Land Loans**		**Amount**	**% of Construction and Land Loans**	
Single family non-owner-occupied	$1,985	6.7	%	$0	0.0	%
Single family owner-occupied	1,056	3.6	%	354	1.8	%
Commercial non-owner-occupied	11,043	37.3	%	1,045	5.3	%
Commercial owner-occupied	5,279	17.8	%	7,782	39.3	%
Land non-owner-occupied	10,239	34.6	%	10,620	53.6	%
Total	**$29,602**	**100.0**	**%**	**$19,801**	**100.0**	**%**

Construction and land loans by geographic location (County)	**Amount**	**% of Construction and Land Loans**		**Amount**	**% of Construction and Land Loans**	
Stanislaus	$10,731	36.3	%	$11,490	58.0	%
Fresno	4,974	16.8	%	0	0.0	%
San Joaquin	2,593	8.8	%	815	4.1	%
Mono	2,350	7.9	%	2,700	13.6	%
Los Angeles	2,150	7.3	%	0	0.0	%
Tuolumne	2,031	6.9	%	0	0.0	%
San Bernardino	1,822	6.1	%	0	0.0	%
Nevada	1,051	3.5	%	0	0.0	%
Calaveras	655	2.2	%	0	0.0	%
Contra Costa	370	1.3	%	370	1.9	%
Amador	309	1.0	%	0	0.0	%
Inyo	113	0.4	%	164	0.9	%
Merced	0	0.0	%	4,254	21.5	%
Other	453	1.5	%	8	0.0	%
Total	**$29,602**	**100.0**	**%**	**$19,801**	**100.0**	**%**

Loan Maturities

The following table shows the contractual maturity distribution and repricing intervals of the outstanding loans in our portfolio, as of December 31, 2015. In addition, the table shows the distribution of such loans between those with variable or floating interest rates and those with fixed or predetermined interest rates. The large majority of the variable rate loans are tied to independent indices (such as the Wall Street Journal prime rate or a Treasury Constant Maturity Rate). Substantially all loans with an original term of more than five years have provisions for the fixed rates to reset, or convert to a variable rate, after one, three or five years.

Loan Maturities and Repricing Schedule

At December 31, 2015

(Dollars in thousands)	**Within One Year**	**After One But Within Five Years**	**After Five Years**	**Total**
Commercial real estate	$81,785	$219,008	$122,254	$423,047
Commercial & industrial	39,847	17,907	6,022	63,776
Consumer	309	412	53	774
Consumer residential	1,479	9,863	21,246	32,588
Agriculture	18,366	1,929	552	20,847
Unearned income	(860)	(1,511)	(911)	(3,282)
Total loans, net of unearned income	$140,926	$247,608	$149,216	$537,750
Loans with variable (floating) interest rates	$129,724	$202,923	$80,769	$413,416
Loans with predetermined (fixed) interest rates	$11,202	$44,685	$68,446	$124,334

The majority of the properties taken as collateral are located in Northern California. We employ strict guidelines regarding the use of collateral located in less familiar market areas. The recent decline in Northern California real estate value is offset by the low loan-to-value ratios in our commercial real estate portfolio and high percentage of owner-occupied properties.

Nonperforming Assets

Financial institutions generally have a certain level of exposure to credit quality risk, and could potentially receive less than a full return of principal and interest if a debtor becomes unable or unwilling to repay. Since loans are the most significant assets of the Company and generate the largest portion of its revenues, the Company's management of credit quality risk is focused primarily on loan quality. Banks have generally suffered their most severe earnings declines as a result of customers' inability to generate sufficient cash flow to service their debts and/or downturns in national and regional economies which have brought about declines in overall property values. In addition, certain debt securities that the Company may purchase have the potential of declining in value if the obligor's financial capacity to repay deteriorates.

Nonperforming assets consist of loans on non-accrual status, loans 90 days or more past due and still accruing interest, loans restructured, where the terms of repayment have been renegotiated resulting in a reduction or deferral of interest or principal and other real estate owned (“OREO”).

Loans are generally placed on non-accrual status when they become 90 days past due, unless management believes the loan is adequately collateralized and in the process of collection. The past due loans may or may not be adequately collateralized, but collection efforts are continuously pursued. Loans may be restructured by management when a borrower has experienced some changes in financial status, causing an inability to meet the original repayment terms, and where we believe the borrower will eventually overcome those circumstances and repay the loan in full. OREO consists of properties acquired by foreclosure or similar means and which management intends to offer for sale.

The Company had nonperforming loans of $5.82 million at December 31, 2015, as compared to $4.70 million at December 31, 2014, $2.34 million at December 31, 2013, $6.92 million at December 31, 2012 and $7.23 million at December 31, 2011. The ratio of nonperforming loans over total loans was 1.07%, 1.03%, 0.56%, 1.77% and 1.83% at December 31, 2015, 2014, 2013, 2012 and 2011, respectively.

In addition, the Company held five OREO properties with outstanding balances of approximately $2.1 million as of December 31, 2015, one of which consisted of residential land acquired through foreclosure that was written down to a zero balance because the public utilities have not been obtainable rendering these land lots unmarketable at this time. One of these properties was acquired from Mother Lode Bank with a balance of $275,000. The Company held three of these same properties with balances of approximately $884,000 and $916,000 as of December 31, 2014 and 2013, respectively. The Company held only the one zero-balance property as of December 31, 2012 as compared to two properties with a market value of $0.2 million as of December 31, 2011.

Management believes that the reserve provided for nonperforming loans, together with the tangible collateral, were adequate as of December 31, 2015. See “Allowance for Loan Losses” below for further discussion. Except as disclosed above, as of December 31, 2015, management was not aware of any material credit problems of borrowers that would cause it to have serious doubts about the ability of a borrower to comply with the present loan payment terms. However, no assurance can be given that credit problems may exist that may not have been brought to the attention of management, or that credit problems may arise.

The following table provides information with respect to the components of our nonperforming assets as of the dates indicated. (The figures in the table are net of the portion guaranteed by the U.S. Government):

(Dollars in Thousands)	**At December 31,**				
	2015	**2014**	**2013**	**2012**	**2011**
Nonaccrual loans(1)					
Commercial real estate	$2,790	$4,363	$2,322	$5,891	$7,129
Commercial and industrial	322	337	18	21	104
Consumer	0	0	0	0	0
Consumer residential	0	0	0	1,011	0
Agriculture	2,704	0	0	0	0
Total	$5,816	$4,700	$2,340	$6,923	$7,233
Loans 90 days or more past due and still accruing (as to principal or interest):					
Commercial real estate	$0	$0	$0	$0	$0
Commercial and industrial	0	0	0	0	0
Consumer	0	0	0	0	0
Consumer residential	0	0	0	0	0
Agriculture	0	0	0	0	0
Total	0	0	0	0	0
Total nonperforming loans	5,816	4,700	2,340	6,923	7,233
Other real estate owned	2,066	884	916	0	244
Total nonperforming assets	$7,882	$5,584	$3,256	$6,923	$7,477
Accruing restructured loans (2)					
Commercial real estate	$0	$0	$0	$0	$0
Commercial and industrial	0	0	0	0	0
Consumer	0	0	0	0	0
Consumer residential	0	0	0	0	0
Agriculture	0	0	0	0	0
Total	0	0	0	0	0
Total impaired loans	$5,816	$4,700	$2,340	$6,923	$7,233
Nonperforming loans as a percentage of total loans	1.07 %	1.03 %	0.56 %	1.77 %	1.83 %
Nonperforming assets as a percentage of total loans and other real estate owned	1.45 %	1.23 %	0.77 %	1.77 %	1.89 %
Allowance for loan losses as a percentage of nonperforming loans	126.48%	160.30%	327.37%	115.19%	119.03%

(1) During the fiscal year ended December 31, 2015 and 2014, no interest income related to these loans was included in net income while on nonaccrual status. Additional interest income of approximately $376,000 and $321,000 would

have been recorded during the year ended December 31, 2015 and 2014, respectively, if these loans had been paid in accordance with their original terms.

(2) A “restructured loan” is one the terms of which were renegotiated to provide a concession because of deterioration in the financial position of the borrower.

Allowance for Loan Losses

In anticipation of credit risk inherent in our lending business, we set aside allowances through charges to earnings. Such charges are not only made for the outstanding loan portfolio, but also for off-balance sheet items, such as commitments to extend credits or letters of credit. The charges made for the outstanding loan portfolio are credited to the allowance for loan losses, whereas charges for off-balance sheet items are credited to the reserve for off-balance sheet items, which is presented as a component of other liabilities. The provision for loan losses is discussed in the section entitled “Provision for Loan Losses” above.

The balance of our allowance for loan losses is Management's best estimate of the remaining losses inherent in the portfolio. The ultimate adequacy of the allowance is dependent upon a variety of factors beyond our control, including the real estate market, changes in interest rate and economic and political environments.

Historically, over the past five years, due to the economic downturn’s effect on the financial stability of certain borrowers, we set aside more reserves for probable loan losses. However, in 2015, amid signs of credit quality improvement, the allowance for loan losses decreased by 2.4%, or $178,000, to $7.36 million at December 31, 2015 as compared with $7.53 million at December 31, 2014. Such allowances were $7.66 million, $7.98 million and $8.61 million at December 31, 2013, 2012 and 2011, respectively. In 2015, the allowance for loan losses as a percentage of total loans decreased corresponding to our improved credit quality, as reflected in the ratios of 1.36%, 1.66%, 1.83%, 2.04% and 2.17%, at the end of 2015, 2014, 2013, 2012 and 2011, respectively. The decrease to 1.36% at the end of 2015 is due in part to the acquisition of $42,831,000 in loans from Mother Lode Bank which are recorded at fair value and therefore do not require a loan loss reserve. Based on the current conditions of the loan portfolio, management believes that the $7.36 million allowance for loan losses at December 31, 2015 is adequate to absorb losses inherent in our loan portfolio. No assurance can be given, however, that adverse economic conditions or other circumstances will not result in increased losses in the portfolio.

Diversification, low loan-to-values, strong credit quality and enhanced credit monitoring contribute to a reduction in the portfolio’s overall risk, and help to offset the economic risk. The impact of the stagnant economic environment will continue to be monitored, and adjustments to the provision for loan loss will be made accordingly. During 2015, the Company recognized net loan charge-offs of $53,000 as compared to net loan recoveries of $1,752,000 in 2014, primarily from one loan for which we received a net settlement of $2,923,000, resulting in a recovery of $1,877,000. In prior years, the weak business climate adversely impacted the financial conditions of some of our clients and resulted in net loan charge-offs of $616,000, $1,784,000 and $1,146,000 in 2013, 2012 and 2011, respectively.

Management reviews these conditions with our senior credit officers. To the extent that any of these conditions is evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management’s estimate of the effect of such condition may be reflected as a specific allowance applicable to such credit or portfolio segment. Where any of these conditions is not evidenced by a specific, identifiable problem credit or portfolio segment as of the evaluation date, management's evaluation of the inherent loss related to such condition is reflected in the unallocated allowance. Although management has allocated a portion of the allowance to specific loan categories, the adequacy of the allowance is considered in its entirety.

Although management believes the allowance at December 31, 2015 was adequate to absorb losses from any known and inherent risks in the portfolio, no assurance can be given that economic conditions which adversely affect our service areas or other variables will not result in increased losses in the loan portfolio in the future.

As of December 31, 2015, our allowance for loan losses consisted of amounts allocated to three phases of our methodology for assessing loan loss allowances, as follows (see details of methodology for assessing allowance for loan losses in the section entitled "Critical Accounting Policies"):

(Dollars in Thousands)	**Years Ended December 31,**		
Phase of Methodology	**2015**	**2014**	**2013**
Specific review of individual loans	$722	$993	$392
Review of portfolio based on loss trends and current economic climate	4,423	4,388	5,362
Review of portfolio based on inherent risk and other subjective factors	2,211	2,153	1,905
	$7,356	$7,534	$7,659

The Components of the Allowance for Loan Losses

As stated previously in "Critical Accounting Policies," the overall allowance consists of a specific allowance for individually identified impaired loans, an allowance factor for categories of credits with similar characteristics and trends, and an allowance for changing environmental factors.

The first component, the specific allowance, results from the analysis of identified problem credits and the evaluation of sources of repayment including collateral, as applicable. Through Management's ongoing loan grading process, individual loans are identified that have conditions that indicate the borrower may be unable to pay all amounts due under the contractual terms. These loans are evaluated individually by Management and specified allowances for loan losses are established when the discounted cash flows of future payments or collateral value of collateral-dependent loans are lower than the recorded investment in the loan. Generally with problem credits that are collateral-dependent, we obtain appraisals of the collateral at least annually. We may obtain appraisals more frequently if we believe the collateral value is subject to market volatility, if a specific event has occurred to the collateral (e.g. tentative map has been filed), or if we believe foreclosure is imminent. Impaired loan balances increased from $4.7 million at December 31, 2014 to $6.1 million at December 31, 2015. The specific allowance totaled $722,000 and $993,000 at December 31, 2015 and 2014, respectively, as we charge off substantially all of our estimated losses related to specifically identified impaired loans as the losses are identified.

The second component, the allowance factor, is an estimate of the probable inherent losses in each loan pool stratified by major categories or loans with similar characteristics in our loan portfolio. This analysis encompasses segmenting and reviewing historical losses, loan grades by pool and current general economic and business conditions. Confirmation of the quality of our grading process is obtained by independent reviews conducted by consultants specifically hired for this purpose and by various bank regulatory agencies. This analysis covers our entire loan portfolio but excludes any loans that were analyzed individually for specific allowances as discussed above. There are limitations to any credit risk grading process. The number of loans makes it impractical to review every loan every quarter. Therefore, it is possible that in the future some currently performing loans not recently graded will not be as strong as their last grading and an insufficient portion of the allowance will have been allocated to them. Grading and loan review often must be done without knowing whether all relevant facts are at hand. Troubled borrowers may deliberately or inadvertently omit important information from reports or conversations with lending officers regarding their financial condition and the diminished strength of repayment sources.

The total amount allocated for the second component is determined by applying loss estimation factors based on loss history to outstanding loans. At December 31, 2015 and 2014, the allowance allocated by categories of credits totaled $4.4 million.

The third component of the allowance for loan losses is an economic and qualitative component that is intended to absorb losses caused by portfolio trends, concentration of credit, growth, and economic trends, as stated previously in

"Critical Accounting Policies". At December 31, 2015 and 2014, the general valuation allowance, including the economic component, totaled $2.2 million. Starting in late 2008, we witnessed financial difficulties experienced by borrowers in our market, where real estate sale prices declined and holding periods increased. In the past several years, while published economic data indicates that the downturn is behind us, it is not clear at what speed the economy will recover. In response to this, we have been proactive in evaluating reserve percentages for economic and other qualitative loss factors used to determine the adequacy of the allowance for loan losses. The increase to the third component of the allowance for loan losses reflected such evaluation.

The table below summarizes, for the periods indicated, loan balances at the end of each period, the daily averages during the period, changes in the allowance for loan losses arising from loans charged off, recoveries on loans previously charged off, additions to the allowance and certain ratios related to the allowance for loan losses:

Allowance for Loan Losses

(Dollars in thousands)	**2015**	**2014**	**2013**	**2012**	**2011**
Balances:					
Average total loans outstanding during period	$466,509	$430,448	$396,953	$390,856	$394,130
Total loans outstanding at end of period	$541,032	$454,471	$419,438	$390,986	$396,202
Allowance for loan losses:					
Balances at beginning of period	$7,534	$7,659	$7,975	$8,609	$8,255
Actual charge-offs:					
Commercial real estate	0	103	436	1,663	1,108
Commercial and Industrial	32	0	0	0	44
Consumer	30	40	22	26	7
Consumer Residential	0	0	178	150	38
Agriculture	0	0	0	0	0
Total charge-offs	62	143	636	1,839	1,197
Recoveries on loans previously charged off:					
Commercial real estate	5	1,882	8	35	30
Commercial and Industrial	0	0	0	1	14
Consumer	4	2	3	4	6
Consumer Residential	0	11	9	15	1
Agriculture	0	0	0	0	0
Total recoveries	9	1,895	20	55	51
Net loan charge-offs (recoveries)	53	(1,752)	616	1,784	1,146
(Reversal of) provision for loan losses	(125)	(1,877)	300	1,150	1,500
Balance at end of period	$7,356	$7,534	$7,659	$7,975	$8,609
Ratios:					
Net loan charge-offs (recoveries) to average total loans	0.01%	-0.41%	0.16%	0.46%	0.29%
Allowance for loan losses to total loans at end of period	1.36%	1.66%	1.83%	2.04%	2.17%
Net loan charge-offs (recoveries) to allowance for loan losses at end of period	0.72%	-23.25%	8.04%	22.37%	13.31%
Net loan charge-offs to provision for loan losses	N/A	N/A	205.33%	155.13%	76.40%

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The table below summarizes the allowance for loan loss balance by type of loan balance at the end of each period (See "Loan Portfolio" above for a description of each type of loan balance):

Allocation of the Allowance for Loan Losses

	Amount Outstanding as of December 31,				
(Dollars in thousands)	**2015**	**2014**	**2013**	**2012**	**2011**
Applicable to:					
Commercial real estate	$5,920	$5,963	$6,248	$6,571	$6,969
Commercial and Industrial	627	720	663	474	606
Consumer	38	42	47	50	65
Consumer Residential	426	388	440	384	348
Agriculture	309	286	217	286	363
Unallocated	36	135	44	210	258
Total Allowance	$7,356	$7,534	$7,659	$7,975	$8,609

Other Earning Assets

For various business purposes, we make investments in earning assets other than the interest-earning securities and loans discussed above. Before 2007, the only other earning assets held by us were insignificant amounts of Federal Home Loan Bank stock, Federal Reserve Bank stock and the cash surrender value on the Company Owned Life Insurances ("BOLI").

During 2007, we invested in a low-income housing tax credit funds ("LIHTCF") to promote our participation in CRA activities. We committed to invest $1 million over a three year period, which was fully funded by the year 2009. We receive the return in the form of tax credits and tax deductions which began in 2007 and are expected to continue through the year 2022. The $1 million contribution is being amortized to other expenses over a term of 15 years, commensurate with the benefits received.

The balances of other earning assets as of December 31, 2015 and December 31, 2014 were as follows:

(Dollars in Thousands)	**December 31, 2015**	**December 31, 2014**
BOLI	$ 13,747	$ 13,545
LIHTCF	$ 388	$ 455
Federal Reserve Bank Stock	$ 758	$ 758
Federal Home Loan Bank Stock	$ 2,958	$ 2,517

Deposits and Other Sources of Funds

Deposits

Total deposits at December 31, 2015 and 2014 were $814,691,000 and $669,581,000, respectively, representing an increase of $145,110,000 or 21.7% in 2015. The Mother Lode Bank acquisition added total deposits of $71,125,000. The average deposits for the year ended December 31, 2015 increased $76,716,000 or 12.4% to $694,991,000 compared to $618,275,000 at December 31, 2014. The Mother Lode Bank acquired deposits had a minimal impact of $1,372,000 on the 2015 average balance.

Deposits are the Company's primary source of funds. Due to strategic emphasis by management, core deposits (based on definition provided by FDIC's Uniform Bank Performance Report) increased by $141 million or 21.4% in 2015 to $798.6 million at December 31, 2015. Included in these totals, is core deposits acquired from Mother Lode Bank totaling $70.4 million. The percentage of core deposits to total deposits decreased slightly to 98.0% at December 31, 2015 as compared to 98.2% at December 31, 2014. The average rate paid on time deposits in denominations of over $250,000 was 0.18% and 0.32% for the years ended December 31, 2015 and 2014, respectively. The composition and cost of the Company's deposit base are important components in analyzing the Company's net interest margin and balance sheet liquidity characteristics, both of which are discussed in greater detail in other sections herein. See "Net Interest Income and Net Interest Margin" for further discussion.

The Company's liquidity is impacted by the volatility of deposits or other funding instruments or, in other words, by the propensity of that money to leave the institution for rate-related or other reasons. Deposits can be adversely affected if economic conditions in California and the Company's market area in particular, continue to weaken. Potentially, the most volatile deposits in a financial institution are jumbo certificates of deposit, meaning time deposits with balances that equal or exceed $250,000, as customers with balances of that magnitude are typically more rate-sensitive than customers with smaller balances.

The following tables summarize the distribution of average daily deposits and the average daily rates paid for the periods indicated:

Distribution of Average Daily Deposits

	Average Deposits					
	2015		**2014**		**2013**	
(Dollars in Thousands)	**Average Balance**	**Average Rate**	**Average Balance**	**Average Rate**	**Average Balance**	**Average Rate**
Demand	$220,033	0.00 %	$191,667	0.00 %	$169,229	0.00 %
Money market	266,856	0.11 %	238,736	0.12 %	238,956	0.14 %
NOW	112,472	0.07 %	97,080	0.07 %	83,268	0.10 %
Savings	48,130	0.11 %	39,820	0.11 %	35,162	0.15 %
Time certificates of deposit over $250,000	14,564	0.18 %	10,141	0.32 %	9,752	0.46 %
Other time deposits	32,936	0.50 %	40,831	0.54 %	45,620	0.68 %
Total deposits	$694,991	0.17 %	$618,275	0.20 %	$581,987	0.27 %

The scheduled maturities of our time deposits in denominations of more than $250,000 at December 31, 2015 are, as follows:

Maturities of Time Deposits over $250,000

(Dollars in Thousands)

Three months or less	$	5,019
Over three months through six months		2,237
Over six months through twelve months		4,860
Over twelve months		2,976
Total	$	15,092

Because our client base is comprised primarily of commercial and industrial accounts, individual account balances are generally higher than those of consumer-oriented banks. Four of our clients carry deposit balances of more than 1% of our total deposits, one of which had a deposit balance of more than 3% of total deposits at December 31, 2015.

The Company had $1.0 million and $1.9 million in brokered deposits as of December 31, 2015 and 2014, respectively. The only brokered deposits the Company holds are from CDARS and ICS, a certificate of deposit and money market account program, respectively, that exchanges funds with other network banks to offer full FDIC insurance coverage to the customer.

FHLB Borrowings

Although deposits are the primary source of funds for our lending and investment activities and for general business purposes, we may obtain advances from the Federal Home Loan Bank of San Francisco ("FHLB") as an alternative to retail deposit funds. Our outstanding FHLB advances were fully paid off during 2012, leaving no outstanding balances as of December 31, 2014 and 2015. See "Liquidity Management" below for the details on the FHLB borrowings program.

The following table is a summary of FHLB borrowings for fiscal years 2015 and 2014:

Dollars in Thousands	**2015**	**2014**
Balance at year-end	$0	$0
Average balance during the year	$12	$1
Maximum amount outstanding at any month-end	$0	$0
Average interest rate during the year	N/A	N/A
Average interest rate at year-end	N/A	N/A

Return on Equity and Assets

The following table sets forth certain information regarding our return on equity and assets for the periods indicated:

	Year Ended December 31,	
	2015	**2014**
Return on average assets	0.63 %	1.03 %
Return on average common equity	6.41 %	10.07%
Dividend payout ratio	34.54%	18.54%
Equity to assets ratio	8.72 %	10.01%

Deferred Compensation Obligations

We maintain a nonqualified, unfunded deferred compensation plan for certain key management personnel. Under this plan, participating employees may defer compensation, which will entitle them to receive certain payments upon retirement, death, or disability. The plan provides for payments commencing upon retirement and reduced benefits upon early retirement, disability, or termination of employment. At December 31, 2015 and 2014, our aggregate payment obligations under this plan totaled $7.7 million and $7.8 million, respectively.

Off-Balance Sheet Arrangements

During the ordinary course of business, we provide various forms of credit lines to meet the financing needs of our customers. These commitments, which represent a credit risk to us, are not represented in any form on our balance sheets.

As of December 31, 2015, and 2014, we had commitments to extend credit of $91.7 million and $84.8 million, respectively. Obligations under standby letters of credit were $1.6 million and $1.1 million at December 31, 2015 and 2014, respectively, and there were no obligations under commercial letters of credit for either period.

The effect on our revenues, expenses, cash flows and liquidity from the unused portion of the commitments to provide credit cannot be reasonably predicted because there is no guarantee that the lines of credit will be used. For more information regarding our off balance sheet arrangements, see Note 14- Commitments and Other Contingencies- to our 2015 year-end consolidated financial statements located elsewhere in this report.

Contractual Obligations

The following chart summarizes certain contractual obligations of the Company as of December 31, 2015 (dollars in thousands):

Contractual Obligations	**Less than 1 Year**	**1-3 years**	**3-5 years**	**More than 5 years**	**Total**
Operating lease obligations	$911	$1,660	$1,431	$2,453	$6,455
Supplemental retirement plans	60	134	280	1,966	2,440
Time deposit maturities	38,295	12,279	0	0	50,574
Total	$39,266	$14,073	$1,711	$4,419	$59,469

As permitted or required under California law and to the maximum extent allowable under that law, we have certain obligations to indemnify our current and former officers and directors for certain events or occurrences while the officer or director is, or was serving, at our request in such capacity. These indemnification obligations are valid as long as the director or officer acted in good faith and in a manner the person reasonably believed to be in, or not opposed to, our best interests, and with respect to any criminal action or proceeding, had no reasonable cause to believe his or her conduct was unlawful. The maximum potential amount of future payments we could be required to make under these indemnification obligations is unlimited; however, we have a director and officer insurance policy that mitigates our exposure and enables us to recover a portion of any future amounts paid. We believe the estimated fair value of these indemnification obligations is minimal.

Liquidity and Asset/Liability Management

Management seeks to ascertain optimum and stable utilization of available assets and liabilities as a vehicle to attain our overall business plans and objectives. In this regard, management focuses on measurement and control of liquidity risk, interest rate risk and market risk, capital adequacy, operation risk and credit risk.

Liquidity

Liquidity to meet borrowers' credit and depositors' withdrawal demands is provided by maturing assets, short-term liquid assets that can be converted to cash and the ability to attract funds from depositors. Additional sources of liquidity may include institutional deposits, advances from the FHLB and other short-term borrowings, such as federal funds purchased.

Since our deposit growth strategy emphasizes core deposit growth we have avoided relying on brokered deposits as a consistent source of funds. The only brokered deposit the Company holds are from CDARS and ICS, a certificate of deposit and money market program, respectively, that exchanges funds with other network banks to offer full FDIC insurance coverage to the customer. The Company had $1.0 million and $1.9 million in brokered deposits as of December 31, 2015 and 2014, respectively.

As a secondary source of liquidity, we rely on advances from the FHLB to supplement our supply of lendable funds and to meet deposit withdrawal requirements. Advances from the FHLB are typically secured by a portion of our loan portfolio and stock issued by the FHLB. The FHLB determines limitations on the amount of advances by assigning a percentage to each eligible loan category that will count towards the borrowing capacity. At December 31, 2015 and 2014, the Company had no FHLB advances outstanding and had sufficient collateral to borrow an additional $198.4 million and $176.7 million, respectively. In addition, the Company had lines of credit with its correspondent banks to purchase overnight federal funds totaling $25 million at December 31, 2015 and 2014. No advances were made on these lines of credit as of December 31, 2015 and December 31, 2014.

The Company's liquidity depends primarily on dividends paid to it as sole shareholder of the Bank. The Bank's ability to pay dividends to the Company will depend on whether the Bank will be in a position to pay dividends based on regulatory requirements and the performance of the Bank.

Maintenance of adequate liquidity requires that sufficient resources be available at all time to meet our cash flow requirements. Liquidity in a banking institution is required primarily to provide for deposit withdrawals and the credit needs of its customers and to take advantage of investment opportunities as they arise. Liquidity management involves our ability to convert assets into cash or cash equivalents without incurring significant loss, and to raise cash or maintain funds without incurring excessive additional cost. For this purpose, we maintain a portion of our funds in cash and cash equivalents, loans and securities available for sale. Our liquid assets at December 31, 2015 and 2014 totaled approximately $269.3 million and $223.5 million, respectively. The acquisition of Mother Lode Bank resulted in additional liquid assets of $23.5 million, net of aggregate cash consideration of $7.3 million paid to Mother Lode Bank shareholders. Our liquidity level measured as the percentage of liquid assets to total assets was 30.0% and 29.8% at December 31, 2015, and 2014, respectively.

Capital Resources and Capital Adequacy Requirements

In the past two years, our primary source of capital has been internally generated operating income through retained earnings. At December 31, 2015, total shareholders' equity increased to $78.3 million, representing an increase of $3.2 million from December 31, 2014. The increase was due to the increase in retained earnings of $4.9 million, offset by a comprehensive loss of $0.3 million due to the negative effect that rising treasury yields had on the unrealized market value adjustment of our available for sale investment portfolio, and by the common stock dividend payments totaling $1.7 million during 2015. The Company did not issue any stock to Mother Lode Bank shareholders, as they were paid 100% in cash, and therefore there was no impact to equity other than the merger related expenses and exclusions of goodwill and intangibles, which are excluded from tangible equity.

As of December 31, 2015, we had no material commitments for capital expenditures.

We are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can trigger regulatory actions that could have a material adverse effect on our financial statements and operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that rely on quantitative measures of our assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. (See "Description of Business-Regulation and Supervision-Capital Adequacy Requirements" herein for exact definitions and regulatory capital requirements.)

As of December 31, 2015, we were qualified as a "well capitalized institution" under the regulatory framework for prompt corrective action. The following table presents the regulatory standards for well-capitalized institutions, compared to the Bank's capital ratios as of the dates specified:

	Regulatory Well-Capitalized Standards	**December 31, 2015**	**December 31, 2014**
Total capital to risk-weighted assets	10.0 %	12.2 %	14.5 %
Tier I capital to risk-weighted assets	8.0 %	11.1 %	13.2 %
Common equity tier 1 risk-weighted assets	6.5 %	11.1 %	N/A
Tier I capital to average assets	5.0 %	9.1 %	10.1 %

Market Risk

Market risk is the risk of loss of future earnings, fair values, or future cash flows that may result from changes in the price of a financial instrument. The value of a financial instrument may change as a result of changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market risk sensitive instruments. Market risk is attributed to all market risk sensitive financial instruments, including securities, loans, deposits and borrowings, as well as the Company's role as a financial intermediary in customer-related transactions. The objective of market risk management is to avoid excessive exposure of the Company's earnings and equity to loss and to reduce the volatility inherent in certain financial instruments.

Interest Rate Management

Market risk arises from changes in interest rates, exchange rates, commodity prices and equity prices. The Company's market risk exposure is primarily that of interest rate risk, and it has established policies and procedures to monitor and limit earnings and balance sheet exposure to changes in interest rates. The Company does not engage in the trading of financial instruments, nor does the Company have exposure to currency exchange rates.

The principal objective of interest rate risk management (often referred to as "asset/liability management") is to manage the financial components of the Company in a manner that will optimize the risk/reward equation for earnings and capital in relation to changing interest rates. The Company's exposure to market risk is reviewed on a regular basis by the Asset/Liability Committee. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income. Management realizes certain risks are inherent, and that the goal is to identify and manage the risks. Management uses two methodologies to manage interest rate risk: (i) a standard GAP analysis; and (ii) an interest rate shock simulation model.

The planning of asset and liability maturities is an integral part of the management of an institution's net interest margin. To the extent maturities of assets and liabilities do not match in a changing interest rate environment, the net interest margin may change over time. Even with perfectly matched repricing of assets and liabilities, risks remain in the form of prepayment of loans or securities or in the form of delays in the adjustment of rates of interest applying to either earning assets with floating rates or to interest bearing liabilities. The Company has generally been able to control its exposure to changing interest rates by maintaining primarily floating interest rate loans and a majority of its time certificates with relatively short maturities.

Interest rate changes do not affect all categories of assets and liabilities equally or at the same time. Varying interest rate environments can create unexpected changes in prepayment levels of assets and liabilities, which may have a significant effect on the net interest margin and are not reflected in the interest sensitivity analysis table. Because of these factors, an interest sensitivity gap report may not provide a complete assessment of the exposure to changes in interest rates.

The Company uses modeling software for asset/liability management in order to simulate the effects of potential interest rate changes on the Company's net interest margin, and to calculate the estimated fair values of the Company's financial instruments under different interest rate scenarios. The program imports current balances, interest rates, maturity dates and repricing information for individual financial instruments, and incorporates assumptions on the characteristics of embedded options along with pricing and duration for new volumes to project the effects of a given interest rate change on the Company's interest income and interest expense. Rate scenarios consisting of key rate and yield curve projections are run against the Company's investment, loan, deposit and borrowed funds portfolios. These rate projections can be shocked (an immediate and parallel change in all base rates, up or down) and ramped (an incremental increase or decrease in rates over a specified time period), based on current trends and econometric models or stable economic conditions (unchanged from current actual levels).

The Company applies a market value ("MV") methodology to gauge its interest rate risk exposure as derived from its simulation model. Generally, MV is the discounted present value of the difference between incoming cash flows on interest-earning assets and other investments and outgoing cash flows on interest-bearing liabilities and other liabilities. The application of the methodology attempts to quantify interest rate risk as the change in the MV which would result from a theoretical 200 basis point (1 basis point equals 0.01%) change in market interest rates. Both a 200 basis point increase and a 200 basis point decrease in market rates are considered for the purpose of the table below. Additionally, management evaluates shocked and ramped scenarios for interest rate changes up to 400 basis points.

At December 31, 2015, it was estimated that the Company's MV would decrease 12.8% in the event of an immediate 200 basis point increase in market interest rates. The Company's MV at the same date would decrease 25.8% in the event of an immediate 200 basis point decrease in applicable interest rates.

Presented below, as of December 31, 2015 and 2014, is an analysis of the Company's interest rate risk as measured by changes in MV for instantaneous and sustained parallel shifts of applicable interest rates:

	December 31, 2015				**December 31, 2014**			
			Market Value as a % of Present Value of Assets				**Market Value as a % of Present Value of Assets**	
	$ Change in Market Value	**% Change in Market Value**	**MV Ratio**	**Change (bp)**	**$ Change in Market Value**	**% Change in Market Value**	**MV Ratio**	**Change (bp)**
	(Dollars in Thousands)							
Shock Scenario								
+200 bp	$(22,458)	(12.88)%	17.47%	(181)	$(19,562)	(12.82)%	18.28%	(100)
+100 bp	$(10,089)	(5.79)%	18.53%	(75)	$(8,356)	(5.47)%	19.41%	13
0 bp	$0	0.00%	19.28%	0	$0	0.00%	20.12%	0
-100 bp	$(20,851)	(11.96)%	16.67%	(261)	$(16,087)	(10.54)%	17.69%	(159)
-200 bp	$(50,759)	(29.12)%	13.31%	(597)	$(39,357)	(25.78)%	14.56%	(472)

Management believes that the MV methodology overcomes three shortcomings of the typical maturity gap methodology. First, it does not use arbitrary repricing intervals and accounts for all expected future cash flows. Second, because the MV method projects cash flows of each financial instrument under different interest rate environments, it can incorporate the effect of embedded options on an institution's interest rate risk exposure. Third, it allows interest rates on different instruments to change by varying amounts in response to a change in market interest rates, resulting in more accurate estimates of cash flows.

However, as with any method of gauging interest rate risk, there are certain shortcomings inherent to the MV methodology. The model assumes interest rate changes are instantaneous parallel shifts in the yield curve. In reality, rate changes are rarely instantaneous. The use of the simplifying assumption that short-term and long-term rates change by the same degree may also misstate historic rate patterns, which rarely show parallel yield curve shifts. Further, the model assumes that certain assets and liabilities of similar maturity or period to repricing will react in the same way to changes in rates. In reality, certain types of financial instruments may react in advance of changes in market rates, while the reaction of other types of financial instruments may lag behind the change in general market rates. When interest rates change, actual loan prepayments and actual early withdrawals from certificates may deviate significantly from the assumptions used in the model. Finally, this methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan clients' ability to service their debt. All of these factors are considered in monitoring the Company's exposure to interest rate risk.

Impact of Inflation; Seasonality

Inflation primarily impacts us by its effect on interest rates. Our primary source of income is net interest income, which is affected by changes in interest rates. We attempt to limit the impact of inflation on our net interest margin through management of rate-sensitive assets and liabilities and the analysis of interest rate sensitivity. The effect of inflation on premises and equipment as well as noninterest expenses has not been significant for the periods covered in this report. Our business is generally not seasonal.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not required.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements and the Independent Auditors' Report appear on pages F-1 through F-49 of this Report and are incorporated into this Item 8 by reference.

INDEX TO FINANCIAL STATEMENTS

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We conducted an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Exchange Act of 1934 (the “Act”)) as of December 31, 2015. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2015.

The term disclosure controls and procedures means controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Act (15 U.S.C. 78a et seq.) is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Act is accumulated and communicated to our Management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There are inherent limitations to the effectiveness of any system of disclosure controls and procedures. These limitations include the possibility of human error, the circumvention or overriding of the controls and procedures and reasonable resource constraints. In addition, because we have designed our system of controls based on certain assumptions, which we believe are reasonable, about the likelihood of future events, our system of controls may not achieve its desired purpose under all possible future conditions. Accordingly, our disclosure controls and procedures provide reasonable assurance, but not absolute assurance, of achieving their objectives.

Management's Annual Report on Internal Control over Financial Reporting

Our Management’s report on Internal Control over Financial Reporting is set forth in Item 8 and is incorporated herein by reference.

Our internal control over financial reporting is designed to provide reasonable, but not absolute, assurance regarding the financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. There are inherent limitations to the effectiveness of any system of internal control over financial reporting. These limitations include the possibility of human error, the circumvention of overriding of the system and reasonable resource constraints. Because of its inherent limitations, our internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

This annual report does not include an attestation report of the Company’s independent registered public accounting firm regarding internal control over financial reporting. Management’s report was not subject to attestation by the Company’s independent registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the Company to provide only management’s report in this annual report.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the quarter ended December 31, 2015 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated by reference from our Proxy Statement to be filed prior to the 2016 Annual Meeting of Shareholders. The Company and the Company have adopted a Code of Ethics that applies to all staff including the Chief Executive Officer, and the Chief Financial Officer. A copy of the Code of Ethics will be provided to any person, without charge, upon written request to Corporate Secretary, Oak Valley Bancorp, 125 North Third Avenue, Oakdale, CA 95361.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's officers and directors, and persons who own more than 10% of a registered class of the Company's equity securities, to file reports of ownership and changes in ownership with the FDIC. Officers, directors and greater than 10% shareholders are required by SEC regulations to furnish the Company with copies of all Section 16(a) forms they file.

Based solely on its review of the copies of such forms received by it, or written representations from certain reporting persons that no Forms 4 and 5 were required for those persons, the Company believes that for the 2015 fiscal year the officers and directors of the Company complied with all applicable filing requirements, except for the late filings for the directors in the table below:

Name	Form	Transaction Type	Transaction Date	# of Shares
Terry Withrow	4	Purchase	11/6/2014	1,330
Terry Withrow	4	Purchase	11/7/2014	1,500
Terry Withrow	4	Purchase	12/1/2014	170
Tom Haidlen	4/A	Adjustment (1)	12/31/2014	10,300
Tom Haidlen	4/A	Adjustment (2)	12/31/2014	(17,837)
Tom Haidlen	4	Purchase (3)	1/30/2015	158
Tom Haidlen	4	Sale	2/6/2015	(1,107)
Tom Haidlen	4	Sale	2/6/2015	(192)
Tom Haidlen	4	Sale	2/6/2015	(96)
Tom Haidlen	4	Sale	2/6/2015	(96)
Tom Haidlen	4	Sale	2/6/2015	(48)
Tom Haidlen	4	Sale	2/6/2015	(190)
Tom Haidlen	4	Sale	2/6/2015	(109)

Tom Haidlen	4	Sale	2/6/2015	(96)
Tom Haidlen	4	Purchase (3)	7/30/2015	159
Jay Gilbert	4	Purchase (3)	7/31/2015	301

(1) Adjustment to holdings for shares held by Mr. Haidlen's spouse.
(2) Adjustment to holdings for shares previously reported in retirement plan for which Mr. Haidlen is the trustee, but not the beneficial owner.
(3) Automatic Reinvestment of Cash Dividend

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference from our Proxy Statement to be filed prior to the 2016 Annual Meeting of Shareholders.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item is incorporated by reference from our Proxy Statement to be filed prior to the 2016 Annual Meeting of Shareholders.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated by reference from our Proxy Statement to be filed prior to the 2016 Annual Meeting of Shareholders.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item is incorporated by reference from our Proxy Statement to be filed prior to the 2016 Annual Meeting of Shareholders.

PART IV

ITEM 15 — EXHIBITS, FINANCIAL STATEMENT SCHEDULES

Documents Filed as Part of this Report:

(a)(1) Financial Statements

The Financial Statements of the Company and the Report of Independent Registered Public Accounting Firm are set forth on pages F-1 through F-49.

(a)(2) Financial Statement Schedules

All schedules to the Financial Statements are omitted because of the absence of the conditions under which they are required or because the required information is included in the Financial Statements or accompanying notes.

(a)(3) Exhibits

The exhibit list required by this Item is incorporated by reference to the Exhibit Index included in this report. The warranties, representations and covenants contained in any of the agreements included herein or which appear as exhibits hereto should not be relied upon by buyers, sellers or holders of the Company's securities and are not intended as warranties, representations or covenants to any individual or entity except as specifically set forth in such agreement

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in Oakdale, California on March 29, 2016.

OAK VALLEY BANCORP
a California corporation

By:	/s/ CHRISTOPHER M. COURTNEY Christopher M. Courtney, *President and Chief Executive Officer*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each of the undersigned officers and directors of the registrant hereby constitutes and appoints Christopher M. Courtney and Jeffrey A. Gall, and each of them, as lawful attorney-in-fact and agent for each of the undersigned (with full power of substitution and resubstitution, for and in the name, place and stead of each of the undersigned officers and directors), to sign and file with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended, any and all amendments, supplements and exhibits to this report and any and all other documents in connection therewith, hereby granting unto said attorneys-in-fact, and each of them, full power and authority to do and perform each and every act and thing necessary or desirable to be done in order to effectuate the same as fully and to all intents and purposes as each of the undersigned might or could do if personally present, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or any of their substitutes, may do or cause to be done by virtue hereof.

Signature	**Title**	**Date**
/s/ DONALD L. BARTON Donald Barton	Director	March 29, 2016

/s/ CHRISTOPHER M. COURTNEY Christopher M. Courtney	Director	March 29, 2016
/s/ JAMES L. GILBERT James L. Gilbert	Director	March 29, 2016
/s/ THOMAS A. HAIDLEN Thomas A. Haidlen	Director	March 29, 2016
/s/ MICHAEL Q. JONES Michael Q. Jones	Director	March 29, 2016
/s/ DANIEL J. LEONARD Daniel J. Leonard	Director	March 29, 2016
/s/ RONALD C. MARTIN Ronald C. Martin	Director	March 29, 2016
/s/ JANET S. PELTON Janet S. Pelton	Director	March 29, 2016
/s/ DANNY L. TITUS Danny L. Titus	Director	March 29, 2016
/s/ TERRANCE P. WITHROW Terrance P. Withrow	Director	March 29, 2016

MANAGEMENT'S ASSESSMENT OF INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed under the supervision of the Company's Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

As of December 31, 2015, management assessed the effectiveness of the Company's internal control over financial reporting based on the criteria for effective internal control over financial reporting established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 COSO) and guidance issued by the Securities and Exchange Commission. Based on the assessment, management determined that the Company maintained effective internal control over financial reporting as of December 31, 2015, based on those criteria.

The Company's management, including its Chief Executive Officer and Chief Financial Officer, does not expect that its disclosure controls and procedures, or its internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefit of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

/s/ CHRISTOPHER M. COURTNEY	/s/ JEFFREY A. GALL
Christopher M. Courtney, President and Chief Executive Officer	Jeffrey A. Gall, Chief Financial Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

Oak Valley Bancorp

We have audited the accompanying consolidated balance sheets of Oak Valley Bancorp and subsidiary (the “Company”) as of December 31, 2015 and 2014 and the related consolidated statements of income, comprehensive income, shareholders’ equity, and cash flows for the years ended December 31, 2015 and 2014. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Oak Valley Bancorp and subsidiary as of December 31, 2015 and 2014, and the consolidated results of their operations and their cash flows for the years ended December 31, 2015 and 2014 in conformity with accounting principles generally accepted in the United States of America.

/s/ Moss Adams LLP

Stockton, California

March 30, 2016

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OAK VALLEY BANCORP

CONSOLIDATED BALANCE SHEETS

(dollars in thousands)	December 31, 2015	December 31, 2014
ASSETS		
Cash and due from banks	$174,778	$132,078
Federal funds sold	15,825	12,210
Cash and cash equivalents	190,603	144,288
Securities available for sale	131,546	121,277
Loans, net of allowance for loan loss of $7,356 and $7,534 at December 31, 2015 and 2014, respectively	530,394	446,492
Bank premises and equipment, net	14,277	14,066
Other real estate owned	2,066	884
Interest receivable and other assets	28,152	22,658
	$897,038	$749,665
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits	$814,691	$669,581
Interest payable and other liabilities	4,084	5,043
Total liabilities	818,775	674,624
Commitments and contingencies (Note 14)		
Shareholders' equity		
Common stock, no par value; 50,000,000 shares authorized, 8,078,155 and 8,074,855 shares issued and outstanding at December 31, 2015 and 2014, respectively	24,682	24,682
Additional paid-in capital	3,217	2,910
Retained earnings	48,795	45,582
Accumulated other comprehensive income, net of tax	1,569	1,867
Total shareholders' equity	78,263	75,041
	$897,038	$749,665

See accompanying notes

OAK VALLEY BANCORP

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share amounts)	YEAR ENDED DECEMBER 31, 2015	2014
INTEREST INCOME		
Interest and fees on loans	$22,053	$22,011
Interest on securities available for sale	3,629	3,708
Interest on federal funds sold	34	38
Interest on deposits with banks	304	179
Total interest income	26,020	25,936
INTEREST EXPENSE		
Deposits	615	647
Total interest expense	615	647
Net interest income	25,405	25,289
Reversal of provision for loan losses	(125)	(1,877)
Net interest income after reversal of provision for loan losses	25,530	27,166
OTHER INCOME		
Service charges on deposits	1,240	1,346
Earnings on cash surrender value of life insurance	429	433
Mortgage commissions	148	157
Gains on called and sold securities	206	209
Other	2,084	1,619
Total non-interest income	4,107	3,764
OTHER EXPENSES		
Salaries and employee benefits	11,717	11,120
Occupancy expenses	3,009	2,902
Data processing fees	1,466	1,336
Regulatory assessments (FDIC & DBO)	506	459
Other operating expenses	5,977	4,417
Total non-interest expense	22,675	20,234
Net income before provision for income taxes	6,962	10,696
PROVISION FOR INCOME TAXES	2,054	3,574
NET INCOME	$4,908	$7,122

NET INCOME PER COMMON SHARE	$0.61	$0.90
NET INCOME PER DILUTED COMMON SHARE	$0.61	$0.89

See accompanying notes

OAK VALLEY BANCORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)	YEAR ENDED DECEMBER 31, 2015	2014
Net income	$4,908	$7,122
Other comprehensive income:		
Unrealized holding (losses) gains on securities arising during the current period, net of tax effect of ($124) thousand and $1.9 million for the years ended December 31, 2015 and 2014, respectively	(177)	2,753
Reclassification adjustment due to net gains realized on calls of securities, net of tax effect of $85 thousand and $86 thousand for the years ended December 31, 2015 and 2014, respectively	(121)	(123)
Total other comprehensive (loss) income	(298)	2,630
Comprehensive income	$4,610	$9,752

See accompanying notes

OAK VALLEY BANCORP

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

YEAR ENDED DECEMBER 31, 2014 AND 2015

(dollars in thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, January 1, 2014	7,929,730	$23,758	$ 2,537	$38,985	$ (763)	$ 64,517
Stock options exercised	122,625	924				924
Tax benefit on stock based compensation			102			102
Restricted stock issued	24,500					0
Restricted stock forfeited	(2,000)					0
Cash dividends declared				(525)		(525)
Stock based compensation			271			271
Other comprehensive income					2,630	2,630
Net income				7,122		7,122
Balances, December 31, 2014	8,074,855	$24,682	$ 2,910	$45,582	$ 1,867	$ 75,041
Restricted stock issued	6,000					$ 0
Restricted stock forfeited	(2,700)					0
Cash dividends declared				(1,695)		(1,695)
Stock based compensation			261			261
Tax benefit on stock based compensation			46			46
Other comprehensive loss					(298)	(298)
Net income				4,908		4,908
Balances, December 31, 2015	8,078,155	$24,682	$ 3,217	$48,795	$ 1,569	$ 78,263

See accompanying notes

OAK VALLEY BANCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)	YEAR ENDED DECEMBER 31, 2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$4,908	$7,122
Adjustments to reconcile net earnings to net cash from operating activities:		
Reversal of provision for loan losses	(125)	(1,877)
Decrease in deferred fees/costs, net	(124)	(178)
Depreciation	1,207	1,174
Amortization of investment securities, net	188	147
Stock based compensation	261	271
Excess tax benefits from exercised stock options	(46)	(102)
Gain on sale of premises and equipment	(5)	(3)
OREO write downs	50	32
Gain on sales and calls of available for sale securities	(206)	(209)
Earnings on cash surrender value of life insurance	(429)	(433)
Deferred tax provision	35	(187)
Gain on BOLI death benefit	(66)	0
(Decrease) increase in interest payable and other liabilities	(1,214)	1,134
Increase in interest receivable	(33)	(13)
(Increase) decrease in other assets	(90)	529
Net cash from operating activities	4,311	7,407
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available for sale securities	(42,694)	(17,883)
Proceeds from maturities, calls, and principal paydowns of securities available for sale	31,935	18,884
Net increase in loans	(41,778)	(33,281)
Purchase of FHLB Stock	(142)	(104)
Purchase of BOLI policies	0	(1,029)
Proceeds from redemption of BOLI policies	292	0
Cash acquired from acquisitions, net of cash paid	23,468	0
Proceeds from sales of premises and equipment	5	3
Net purchases of premises and equipment	(1,418)	(1,556)
Net cash used in investing activities	(30,332)	(34,966)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Shareholder cash dividends paid	(1,695)	(1,318)
Net increase in demand deposits and savings accounts	77,313	71,529
Net decrease in time deposits	(3,328)	(4,581)
Excess tax benefits from stock-based payment arrangements	46	102
Proceeds from sale of common stock and exercise of stock options	0	924

Net cash from financing activities	72,336	66,656
NET INCREASE IN CASH AND CASH EQUIVALENTS	46,315	39,097
CASH AND CASH EQUIVALENTS, beginning of period	144,288	105,191
CASH AND CASH EQUIVALENTS, end of period	$190,603	$144,288
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$618	$668
Income taxes	$4,152	$3,005
NON-CASH INVESTING ACTIVITIES:		
Real estate acquired through foreclosure	$956	$0
Change in unrealized (loss) gain on available-for-sale securities	$(507)	$4,470
Acquisitions:		
Fair value of assets acquired	$78,717	$0
Fair value of liabilities assumed	$71,381	$0

See accompanying notes

OAK VALLEY BANCORP

NOTES TO FINANCIAL STATEMENTS

NOTE 1 — SUMMARY OF ACCOUNTING POLICIES

Introductory Explanation

On July 3, 2008 (the "Effective Date"), a bank holding company reorganization was completed whereby Oak Valley Bancorp ("Bancorp") became the parent holding company for Oak Valley Community Bank (the "Bank"). On the Effective Date, a tax-free exchange was completed whereby each outstanding share of the Company was converted into one share of Bancorp and the Company became the sole wholly-owned subsidiary of the holding company.

The consolidated financial statements include the accounts of Bancorp and its wholly-owned bank subsidiary. All material intercompany transactions have been eliminated. In the opinion of Management, the consolidated financial statements contain all adjustments necessary to present fairly the financial position, results of operations, changes in shareholders' equity and cash flows. All adjustments are of a normal, recurring nature.

Oak Valley Community Bank is a California State chartered bank. The Company was incorporated under the laws of the state of California on May 31, 1990, and began operations in Oakdale on May 28, 1991. The Company operates branches in Oakdale, Sonora, Bridgeport, Bishop, Mammoth Lakes, Modesto, Manteca, Patterson, Turlock, Ripon, Stockton, and Escalon, California. The Bridgeport, Mammoth Lakes, and Bishop branches operate as a separate division, Eastern Sierra Community Bank. The Company's primary source of revenue is providing loans to customers who are predominantly middle-market businesses.

On December 23, 2015, the Company completed its acquisition of Mother Lode Bank ("MLB"), a California state-chartered bank headquartered in Sonora, California, in a transaction in which Mother Lode Bank was merged with and into the Bank, with the Bank as the surviving company in the transaction. The purchase price for Mother Lode Bank was approximately $7.3 million. As of the acquisition date, Mother Lode Bank's total assets were $78.7 million and total deposits were $71.1 million.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant accounting estimates reflected in the Company's consolidated financial statements include the allowance for loan losses, accounting for income taxes, other-than-temporary impairment of investment securities, fair value measurements, and the determination, recognition and measurement of impaired loans. Actual results could differ from these estimates.

A summary of the significant accounting policies applied in the preparation of the accompanying consolidated financial statements follows.

Subsequent events — The Company has evaluated events and transactions subsequent to December 31, 2015for potential recognition or disclosure.

Cash and cash equivalents — The Company has defined cash and cash equivalents to include cash, due from banks, certificates of deposit with original maturities of three months or less, and federal funds sold. Generally, federal funds are sold for one-day periods. At times throughout the year, balances can exceed FDIC insurance limits.

Securities available for sale — Available-for-sale securities consist of bonds, notes, and debentures not classified as trading securities or held-to-maturity securities. Available-for-sale securities with unrealized holding gains and losses, net of tax, are reported as an amount in accumulated other comprehensive income, net of tax. Gains and losses on the sale of available-for-sale securities are determined using the specific identification method. The amortization of premiums and accretion of discounts are recognized as adjustments to interest income over the period to maturity.

Investments with fair values that are less than amortized cost are considered impaired. Impairment may result from either a decline in the financial condition of the issuing entity or, in the case of fixed interest rate investments, from rising interest rates. At each consolidated financial statement date, management assesses each investment to determine if impaired investments are temporarily impaired or if the impairment is other than temporary. This assessment includes a determination of whether the Company intends to sell the security, or if it is 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 credit losses. For debt securities that are considered other than temporarily impaired and that the Company does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, the amount of impairment is separated into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is calculated as the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of the future expected cash flows is deemed to be due to factors that are not credit related and is recognized in other comprehensive income. If the Company sold an impaired security, both the credit loss component and amount due to other factors would be recognized through earnings as described above.

Other real estate owned — Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value of the property at the date of foreclosure less estimated selling costs. Subsequent to foreclosure, valuations are periodically performed and any subject revisions in the estimate of fair value are reported as adjustment to the carrying value of the real estate, provided the adjusted carrying amount does not exceed the original amount at foreclosure. Revenues and expenses from operations and changes in the valuation allowance are included in other operating expenses.

Loans originated — Loans are reported at the principal amount outstanding, net of unearned income, deferred loan fees, and the allowance for loan losses. Unearned discounts on installment loans are recognized as income over the terms of the loans. Interest on other loans is calculated by using the simple interest method on the daily balance of the principal amount outstanding.

Loan fees net of certain direct costs of origination are deferred and amortized, as an adjustment to interest yield, over the estimated life of the loan.

Loans on which the accrual of interest has been discontinued are designated as non-accrual loans. Accrual of interest on loans is discontinued either when reasonable doubt exists as to the full and timely collection of interest or principal or when a loan becomes contractually past due by ninety days or more with respect to interest or principal. When a loan is placed on non-accrual status, all interest previously accrued, but not collected, is reversed against current period interest income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

Allowance for loan losses — The allowance for loan losses is established through a provision for loan losses charged to operations. Loans are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. Subsequent recoveries of previously charged off amounts, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based on management’s periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additional allowance based on their judgment about information available to them at the time of their examination.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. Impaired loans, as defined, are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. The general component relates to non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

The Company considers a loan impaired when it is probable that all amounts of principal and interest due, according to the contractual terms of the loan agreement, will not be collected. Interest income is recognized on impaired loans in the same manner as non-accrual loans. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

The method for calculating the allowance for unfunded loan commitments is based on an allowance percentage which is less than other outstanding loan types because they are at a lower risk level. This allowance percentage is evaluated by management periodically and is applied to the total undisbursed loan commitment balance to calculate the allowance for off-balance-sheet commitments.

The Company considers a loan to be a troubled debt restructure (“TDR”) when the Company has granted a concession and the borrower is experiencing financial difficulty. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company’s internal underwriting policy. A TDR loan is kept on non-accrual status until the borrower has paid for six consecutive months with no payment defaults, at which time the TDR is placed back on accrual status. A TDR loan is impaired and a specific valuation allowance is allocated, if necessary, so that the TDR loan is reported net, at the present value of estimated future cash flows using the TDR loan’s existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

Acquired Loans and Leases — Loans and leases acquired through purchase or through a business combination are recorded at their fair value at the acquisition date. Credit discounts, which reflect estimates of credit losses, expected to be incurred over the life of the loan, are included in the determination of fair value; therefore, an allowance for loan and lease losses is not recorded at the acquisition date.

Acquired loans are evaluated upon acquisition for evidence of deterioration in credit quality since their origination to determine if it is probable the Company will be unable to collect all contractually required payments. These loans are classified as Purchased Credit Impaired (“PCI”) loans, while all other acquired loans are classified as non-PCI loans. The Company has elected to account for PCI loans at the individual loan level. The Company estimates the amount and timing of expected cash flows for each loan. The expected cash flow in excess of the loan's carrying value, is referred to as the accretable yield, and is recorded as interest income over the remaining expected life of the loan. The excess of the loan's contractual principal and interest over expected cash flows is referred to as the non-accretable difference, and is representative of contractual amounts the Company does not expect to collect. The non-accretable difference is not recorded in the Company's consolidated financial statements.

Quarterly, management performs an evaluation of expected future cash flows for PCI loans. If current expectations of future cash flows are less than management's previous expectations, other than due to decreases in interest rates and prepayment assumptions, an allowance for loan and leases losses is recorded with a charge to provision for loan and lease losses. If there has been a probable and significant increase in expected future cash flows over that which was previously expected, the Company first reduces any previously established allowance for loan and lease losses, and then records an adjustment to interest income through a prospective increase in the accretable yield.

For acquired loans not considered credit impaired (“non-PCI”), we recognize the entire fair value discount accretion to interest income, based on contractual cash flows using an effective interest rate method for term loans, and on a straight line basis for revolving lines. When a non-PCI loan is placed on non-accrual status subsequent to acquisition, accretion stops until the loan is returned to accrual status. The level of accretion on non-PCI loans varies from period to period due to maturities and early pay-offs of these loans during the reporting periods. Subsequent to acquisition, if the probable and estimable losses for non-PCI loans exceed the amount of the remaining unaccreted discount, the excess is established as an allowance for loan losses. All acquired loans were acquired in acquisitions and do not represent loans purchased from third parties.

Premises and equipment — Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives using the straight-line basis. The estimated lives used in determining depreciation and amortization are:

Building (in years)	31.5	
Equipment (in years)	3–	12
Furniture and fixtures (in years)	3–	7
Leasehold improvements (in years)	5–	15
Automobiles (in years)	3–	5

Leasehold improvements are amortized over the lesser of the useful life of the asset or the remaining term of the lease. The straight-line method of depreciation is followed for all assets for financial reporting purposes, but accelerated methods are used for tax purposes. Deferred income taxes have been provided for the resulting temporary differences.

Income taxes — Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company’s assets and liabilities. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled using the liability method. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

The Company files income tax returns in the U.S. federal jurisdiction, and the state of California. With few exceptions, the Company is no longer subject to U.S. federal or state/local income tax examinations by tax authorities for years before 2011.

Transfers of financial assets — Transfers of an entire financial asset, a group of financial assets, or a participating interest in an entire financial asset are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that contain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Advertising costs — The Company expenses marketing costs as they are incurred. Advertising expense was $189,000 and $215,000 for the years ended December 31, 2015 and 2014, respectively.

Comprehensive income — Comprehensive income is comprised of net income and other comprehensive income. Other comprehensive income includes items previously recorded directly to equity, such as unrealized gains and losses on securities available for sale. Comprehensive income is presented in the statements of comprehensive income and as a component of shareholders' equity. For the years ended December 31, 2015 and 2014, $121,000 and $123,000 net of tax, respectively, was reclassified from comprehensive income into net income related to gains on called available for sale securities.

Investment in limited partnership — During 2007 the Company acquired limited interests in a private limited partnership that acquires affordable housing properties in California that generate Low Income Housing Tax Credits under Section 42 of the Internal Revenue Code of 1986, as amended. The Company's limited partnership investment is accounted for under the equity method. The Company's noninterest expense associated with the utilization of these tax credits for the year ended December 31, 2015 and 2014 was $67,000 and $61,000, respectively. The limited partnership investment is expected to generate a total tax benefit of approximately $1.16 million over the life of the investment for the combination of the tax credits and deductions on noninterest expense. The tax credits expire between 2015 and 2022. In 2014, a tax benefit of $89,000 was utilized for income tax purposes and an estimated amount of $88,000 will be utilized for 2015. The recorded investment in limited partnerships totaled $388,000 and $455,000 at December 31, 2015 and 2014, respectively, and is reflected as a component of interest receivable and other assets on the consolidated balance sheets.

Federal Reserve Bank Stock — Federal Reserve Bank stock represents the Company's investment in the stock of the Federal Reserve Bank ("FRB") and is carried at par value, which reasonably approximates its fair value. While technically these are considered equity securities, there is no market for the FRB stock. Therefore, the shares are considered as restricted investment securities. Management periodically evaluates FRB stock for other-than-temporary impairment. Management's determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FRB as compared to the capital stock amount for the FRB and the length of time this situation has persisted, (2) commitments by the FRB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FRB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FRB, and (4) the liquidity position of the FRB. This investment is reflected as a component of interest receivable and other assets on the consolidated balance sheets.

Federal Home Loan Bank Stock — Federal Home Loan Bank stock represents the Company's investment in the stock of the Federal Home Loan Bank of San Francisco ("FHLB") and is carried at par value, which reasonably approximates its fair value. While technically these are considered equity securities, there is no market for the FHLB stock. Therefore, the shares are considered as restricted investment securities. Management periodically evaluates FHLB stock for other-than-temporary impairment. Management's determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB. This investment is reflected as a component of interest receivable and other assets on the consolidated balance sheets.

Earnings per common share (“EPS”) — EPS is based upon the weighted average number of common shares outstanding during each year. The table in footnote 14 shows: (1) weighted average basic shares, (2) effect of dilutive securities related to stock options and non-vested restricted stock, and (3) weighted average diluted shares. Net income is calculated as net income reduced by dividends accumulated on preferred stock. Basic EPS are calculated by dividing net income by the weighted average number of common shares outstanding during each period, excluding unvested restricted stock awards. Diluted EPS are calculated using the weighted average diluted shares. The total dilutive shares included in annual diluted EPS is a year-to-date weighted average of the total dilutive shares included in each quarterly diluted EPS computation under the treasury stock method. We have two forms of outstanding common stock: common stock and unvested restricted stock awards. Holders of restricted stock awards receive non-forfeitable dividends at the same rate as common stockholders and they both share equally in undistributed earnings. Therefore, under the two-class method, the difference in EPS is not significant for these participating securities.

Stock based compensation — The Company recognizes in the consolidated statements of income the grant-date fair value of stock options and other equity-based forms of compensation issued to employees over the employees’ requisite service period (generally the vesting period). The Company uses the straight-line recognition of expenses for awards with graded vesting.

The fair value of each option grant is estimated as of the grant date using a binomial option-pricing model for all grants. Expected volatility is based on the historical volatility of the price of the Company’s stock. The Company uses historical data to estimate option exercise and stock option forfeiture rates within the valuation model. The expected term of options granted for the binomial model is derived from applying a historical suboptimal exercise factor to the contractual term of the grant. For binomial pricing, the risk-free rate for periods is equal to the U.S. Treasury yield at the time of grant and commensurate with the contractual term of the grant. There were no stock options granted in 2015 or 2014.

Fair values of financial instruments — The consolidated financial statements include various estimated fair value information as of December 31, 2015 and 2014. Such information, which pertains to the Company’s financial instruments, does not purport to represent the aggregate net fair value of the Company. Further, the fair value estimates are based on various assumptions, methodologies, and subjective considerations, which vary widely among different financial institutions and which are subject to change.

Fair value measurements — The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The Company bases the fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Securities available for sale, derivatives, and loans held for sale, if any, are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record certain assets at fair value on a non-recurring basis, such as certain impaired loans held for investment and securities held to maturity that are other-than-temporarily impaired. These non-recurring fair value adjustments typically involve write-downs of individual assets due to application of lower-of-cost or market accounting.

The Company has established and documented a process for determining fair value. The Company maximizes the use of observable inputs and minimizes the use of unobservable inputs when developing fair value measurements. Whenever there is no readily available market data, Management uses its best estimate and assumptions in determining fair value, but these estimates involve inherent uncertainties and the application of Management's judgment. As a result, if other assumptions had been used, our recorded earnings or disclosures could have been materially different from those reflected in these financial consolidated statements.

Reclassifications — Certain prior year amounts have been reclassified to conform to the current year presentation. There was no effect on net income or shareholders’ equity as a result of reclassifications.

Business combinations and related matters — Business combinations are accounted for under the acquisition method of accounting in accordance with ASC 805, Business Combinations. Under the acquisition method the acquiring entity in a business combination recognizes 100 percent of the acquired assets and assumed liabilities, regardless of the percentage owned, at their estimated fair values as of the date of acquisition. Any excess of the purchase price over the fair value of net assets and other identifiable intangible assets acquired is recorded as goodwill. Assets acquired and liabilities assumed from contingencies must also be recognized at fair value, if the fair value can be determined during the measurement period. Results of operations of an acquired business are included in the statement of operations from the date of acquisition. Acquisition-related costs, including conversion charges, are expensed as incurred. The Company applied this guidance to the acquisition of Mother Lode Bank that was consummated on December 23, 2015. The Company's consolidated financial statements reflect the operations of Mother Lode Bank from December 24, 2015 through December 31, 2015.

Goodwill and other intangible assets — Intangible assets are comprised of goodwill and core deposit intangibles acquired in the Mother Lode Bank Acquisition. Intangible assets with definite useful lives are amortized over their respective estimated useful lives. If an event occurs that indicates the carrying amount of an intangible asset may not be recoverable, management reviews the asset for impairment. Any goodwill and any intangible asset acquired in a purchase business combination determined to have an indefinite useful life is not amortized, but is evaluated for impairment, at a minimum, on an annual basis.

The Company applies a qualitative analysis of conditions in order to determine if it is more likely than not that the carrying value is impaired. In the event that the qualitative analysis suggests that the carrying value of goodwill may be impaired, the Company, with the assistance of an independent third party valuation firm, uses several quantitative valuation methodologies in evaluating goodwill for impairment including a discounted cash flow approach that includes assumptions made concerning the future earnings potential of the organization, and a market-based approach that looks at values for organizations of comparable size, structure and business model. The current year's review of qualitative factors did not indicate that impairment has occurred, as such no quantitative analysis was performed at December 31, 2015.

Recently Issued Accounting Standards —

In January 2014, the FASB issued ASU No. 2014 – 01, Investments – Equity Method and Joint Ventures (Topic 323), Accounting for Investments in Qualified Affordable Housing Projects. This Update provides guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit. The amendments in this Update permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this Update are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. The adoption of ASU No. 2014-01 did not have a material impact on the Company's consolidated financial statements.

In January 2014, the FASB issued ASU No. 2014 – 04, Receivables – Troubled Debt Restructurings by Creditors. This ASU provides clarification that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The adoption of ASU No. 2014-04 did not have a material impact on the Company's consolidated financial statements.

In August 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-14 *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40), Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure*. This update addresses classification of government-guaranteed mortgage loans, including those where guarantees are offered by the Federal Housing Administration (“FHA”), the U.S. Department of Housing and Urban Development (“HUD”), and the U.S. Department of Veterans Affairs (“VA”). Although current accounting guidance stipulates proper measurement and classification in situations where a creditor obtains from a debtor, assets in satisfaction of a receivable (such as through foreclosure), current guidance does not specify how to measure and classify foreclosed mortgage loans that are government-guaranteed. Under the provisions of this update, a creditor would derecognize a mortgage loan that has been foreclosed upon, and recognize a separate receivable if the following conditions are met: (1) the loan has a government guarantee that is not separable from the loan before foreclosure, (2) At the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim, (3) At the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. The amendments within this update are effective for annual and interim periods beginning after December 15, 2014. The adoption of this update did not have a material impact of the Company’s consolidated financial statements.

In September, 2015, the FASB issued ASU No. 2015-16, Simplifying the Accounting for Measurement Period Adjustments (Topic 805). This ASU eliminates the requirement to restate prior period financial statements for measurement period adjustments to assets acquired and liabilities assumed in a business combination. The new guidance under this update requires the cumulative impact of measurement period adjustments be recognized in the period the adjustment is determined. This update does not change what constitutes a measurement period adjustment, nor does it change the length of the measurement period. The new standard is effective for interim annual periods beginning after December 15, 2015 and should be applied prospectively to measurement period adjustments that occur after the effective date. The adoption of this update is not expected to have a material impact on the Company’s consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in this ASU make improvements to

GAAP related to financial instruments that include the following as applicable to us.

Equity investments, except for those accounted for under the equity method of accounting or those that result in consolidation of the investee, are required to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.

Simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment - if impairment exists, this requires measuring the investment at fair value.

Eliminates the requirement for public companies to disclose the method(s) and significant assumptions used to estimate the fair value that is currently required to be disclosed for financial instruments measured at amortized cost on the balance sheet.

Public companies will be required to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes.

Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements.

The reporting entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

ASU 2016-01 is effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. This ASU will impact our financial statement disclosures, however, we do not expect this ASU to have a material impact on our financial condition or results of operations.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). This ASU was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities, including leases classified as operating leases under previous GAAP, on the balance sheet and requiring additional disclosures of key information about leasing arrangements. ASU 2016-02 is effective for annual periods, including interim periods within those annual periods beginning after December 15, 2018 and requires a modified retrospective approach to adoption. Early application of the amendments is permitted. We are currently evaluating the provisions of this ASU and will be monitoring developments and additional guidance to determine the potential outcome the amendments will have on our financial condition and results of operations.

NOTE 2 – BUSINESS COMBINATION

On December 23, 2015, in effort to expand our market presence and enhance shareholder value, the Company acquired 100% of the outstanding common shares of Mother Lode Bank ("MLB") and all unexercised options to purchase MLB common stock were cancelled, in exchange for $7,336,000 in cash (the "MLB Acquisition"). In conjunction with the MLB Acquisition, MLB was merged with and into Oak Valley Community Bank. On January 29, 2016, the two acquired MLB branches in Sonora were closed after management determined that our two existing branches in Sonora would be able to support our new customers. The assets acquired and liabilities assumed, both tangible and intangible, were recorded at their fair values as of the acquisition date in accordance with ASC 805, Business Combinations.

The following table reflects the estimated fair values of the assets acquired and liabilities assumed related to the MLB Acquisition:

(Dollars in thousands)	Acquisition Date December 23, 2015
Assets:	
Cash and cash equivalents	$ 30,804
Loans	42,831
Core deposit intangible	1,031
Deferred tax asset	2,651
Goodwill	662
Other assets	738
Total assets acquired	$ 78,717
Liabilities:	
Deposits:	
Non-interest bearing	$ 36,177
Interest bearing	
Transaction accounts	6,112
Savings accounts	15,727
Money market accounts	7,602
Other time accounts	5,507
Total deposits	71,125
Other liabilites	256
Total liabilities assumed	$ 71,381
Merger consideration	$ 7,336

The following table presents the net assets acquired from MLB and the estimated fair value adjustments:

(Dollars in thousands)	Acquisition Date December 23, 2015
Book value of net assets acquired from Mother Lode Bank	$ 4,884
Fair value adjustments:	
Loans	(2,960)
Reversal of Allowance for Loan Loss	1,279
Core deposit intangible asset	1,031
Other assets & liabilities, net	(210)
Total purchase accounting adjustments	$ (860)
Deferred tax asset (tax effect of purchase accounting adjustments at 41.15%)	354
DTA Carryforward	2,296
Fair value of net assets acquired from Mother Lode Bank	$ 6,674
Merger consideration	7,336
Less: fair value of net assets acquired	(6,674)
Goodwill	$ 662

As a result of the MLB Acquisition, we recorded $662,000 in goodwill, which represents the excess of the total purchase price paid over the fair value of the assets acquired, net of the fair values of liabilities assumed. Goodwill mainly reflects expected value created through the combined operations of MLB and the Company. At December 31, 2015, we determined that the fair value of our traditional community banking activities (provided through our branch network) exceeded the carrying amount. Therefore, no impairment on goodwill has been recorded. The goodwill is not deductible for tax purposes. The following is a description of the methods used to determine the fair values of significant assets and liabilities at acquisition date presented above.

Loans

As discussed in Note 1, the fair values for acquired loans were developed based upon the present values of the expected cash flows utilizing market-derived discount rates. Expected cash flows for each acquired loan were projected based on contractual cash flows adjusted for expected prepayment, expected default (i.e. probability of default and loss severity), and principal recovery.

Prepayment rates were applied to the principal outstanding based on the type of loan, where appropriate. Prepayments were based on a constant prepayment rate ("CPR") applied across the life of a loan. The annual CPRs were between 0% and 5%, depending on the characteristics of the loan pool (e.g. construction, commercial real estate, etc.).

Non-credit-impaired loans with similar characteristics were grouped together and were treated in the aggregate when applying the discount rate on the expected cash flows. Aggregation factors considered included the type of loan and related collateral, risk classification, fixed or variable interest rate, term of loan and whether or not the loan was amortizing. See Notes 1 and 5 for additional information.

Core Deposit Intangible

The core deposit intangible represents the estimated future benefits of acquired deposits and is booked separately from the related deposits. The value of the core deposit intangible asset was determined using a discounted cash flow approach to arrive at the cost differential between the core deposits (non-maturity deposits such as transaction, savings and money market accounts) and alternative funding sources. It is calculated as the present value of the difference in cash flows between maintaining the core deposits (interest and net maintenance costs) and the cost of an equal amount of funds with a similar term from an alternative source. The core deposit intangible is amortized on an accelerated basis over an estimated ten-year life, and it is evaluated periodically for impairment. No impairment loss was recognized in 2015. A core deposit intangible asset of $1,031,000 was recorded in conjunction with the Acquisition, which will begin to amortize in 2016.

Pro Forma Results of Operations

Included in the Company's consolidated statement of income for the year ended December 31, 2015, was revenue of $64,000 and net income of $37,000 related to normal business operations of MLB.

The following table presents unaudited pro forma information as if the MLB Acquisition had occurred on January 1, 2014, which includes the pre-acquisition period for MLB. The unaudited pro forma information includes adjustments for interest income on loans acquired, amortization of intangibles arising from the transaction, interest expense on deposits acquired, operating expenses including salaries, servicing costs on loan and deposit accounts and merger related expenses, and the related income tax effects. The unaudited pro forma financial information is not necessarily indicative of the results of operations that would have occurred had the transaction been effected on the assumed date.

(dollars in thousands, except per share data)	**For the Years Ended December 31,**	
	2015	**2014**
	(Unaudited)	**(Unaudited)**
Net interest income	$28,258	$ 28,293
Provision for loan and lease losses	(125)	(1,877)
Non-interest income	4,434	4,088
Non-interest expense	21,606	23,442
Income before income taxes	11,211	10,816
Income tax expense	3,611	3,814
Net income	$7,600	$ 7,002
Earnings Per Common Share		
Basic	$0.95	$ 0.88
Diluted	$0.95	$ 0.88

Acquisition-related expenses are recognized as incurred and continue until all systems have been converted and operational functions become fully integrated. We incurred one-time third-party acquisition-related expenses in the consolidated statements of income in 2015 as follows:

(Dollars in thousands)	
Data processing	$1,137
Professional services	582

Personnel severance	210
Other	42
	$1,971

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NOTE 3 — CASH AND DUE FROM BANKS

Cash and due from banks includes balances with the Federal Reserve Bank and other correspondent banks. The Company is required to maintain specified reserves by the Federal Reserve Bank. The average reserve requirements are based on a percentage of the Company's deposit liabilities. In addition, the Federal Reserve Bank requires the Company to maintain a certain minimum balance at all times. As of December 31, 2015 the Company had a balance of $107,792,000 which exceeds the reserve requirement.

NOTE 4 — SECURITIES

The amortized cost and estimated fair values of debt securities as of December 31, 2015, are as follows:

(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. agencies	$ 31,815	$ 1,142	$ (89)	$32,868
Collateralized mortgage obligations	2,729	17	(27)	2,719
Municipalities	66,535	2,248	(197)	68,586
SBA pools	811	0	(5)	806
Corporate debt	13,497	44	(121)	13,420
Asset backed securities	10,321	0	(183)	10,138
Mutual fund	3,172	0	(163)	3,009
	$ 128,880	$ 3,451	$ (785)	$131,546

The following tables detail the gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2015.

(dollars in thousands)	Less than 12 months		12 months or more		Total	
<u>Description of Securities</u>	**Fair**	**Unrealized**	**Fair**	**Unrealized**	**Fair**	**Unrealized**

	Value	Loss	Value	Loss	Value	Loss
U.S. agencies	$7,129	$ (30)	$1,800	$ (59)	$8,929	$ (89)
Collateralized mortgage obligations	0	0	1,266	(27)	1,266	(27)
Municipalities	11,451	(123)	3,680	(74)	15,131	(197)
SBA pools	0	0	807	(5)	807	(5)
Corporate debt	9,376	(121)	0	0	9,376	(121)
Asset backed securities	5,351	(78)	4,787	(105)	10,138	(183)
Mutual fund	0	0	3,009	(163)	3,009	(163)
Total temporarily impaired securities	$33,307	$ (352)	$15,349	$ (433)	$48,656	$ (785)

At December 31, 2015, there was one U.S. agency, one collateralized mortgage obligation, six municipalities, two SBA pools, three asset backed securities, and one mutual fund that comprised the total securities in an unrealized loss position for greater than 12 months and four U.S. agencies, nine municipalities, seven corporate debts, and three asset backed securities that make up the total securities in a loss position for less than 12 months. 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. This evaluation encompasses various factors including, the nature of the investment, the cause of the impairment, the severity and duration of the impairment, credit ratings and other credit related factors such as third party guarantees and volatility of the security's fair value. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due primarily to interest rate changes and the Company does not intend to sell the securities and it is not likely that we will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security.

The amortized cost and estimated fair value of debt securities at December 31, 2015, by contractual maturity or call date, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(dollars in thousands)	**Amortized CostCost**	**Fair Value**
Available-for-sale securities:		
Due in one year or less	$ 9,523	$ 9,863
Due after one year through five years	40,153	41,491
Due after five years through ten years	48,379	48,847
Due after ten years	30,825	31,345
	$ 128,880	$ 131,546

The amortized cost and estimated fair values of debt securities as of December 31, 2014, are as follows:

(dollars in thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Available-for-sale securities:				
U.S. agencies	$ 40,316	$ 1,760	$ (146)	$ 41,930
Collateralized mortgage obligations	6,927	184	(39)	7,072
Municipalities	49,396	1,713	(212)	50,897
SBA pools	895	0	(3)	892
Corporate debt	6,726	95	(17)	6,804
Asset backed securities	10,766	50	(106)	10,710
Mutual fund	3,077	0	(105)	2,972
	$ 118,103	$ 3,802	$ (628)	$ 121,277

The following tables detail the gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2014.

(dollars in thousands)	**12 months or more**	**Total**

Description of Securities	Less than 12 months Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. agencies	$0	$ 0	$8,446	$ (146)	$8,446	$ (146)
Collateralized mortgage obligations	0	0	1,445	(39)	1,445	(39)
Municipalities	3,530	(22)	12,791	(190)	16,321	(212)
SBA pools	0	0	892	(3)	892	(3)
Corporate debt	1,983	(17)	0	0	1,983	(17)
Asset backed securities	3,798	(79)	971	(27)	4,769	(106)
Mutual fund	0	0	2,972	(105)	2,972	(105)
Total temporarily impaired securities	$9,311	$ (118)	$27,517	$ (510)	$36,828	$ (628)

The Company recognized gross realized gains of $238,000 and $209,000 during 2015 and 2014, respectively, on certain available-for-sale securities that were called or sold. The gains in 2015 reflected in the condensed consolidated statements of income are net of a $32,000 gross realized loss related to one available-for-sale security sold during the first quarter of 2015, compared to no sales of securities during 2014. There were no losses on called available-for-sale securities realized during 2015 and 2014.

Securities carried at $65,902,000 and $60,474,000 at December 31, 2015 and 2014, respectively, were pledged to secure deposits of public funds.

NOTE 5 — LOANS

The Company's customers are primarily located in Stanislaus, San Joaquin, Tuolumne, Inyo, and Mono Counties. As of December 31, 2015, approximately 78% of the Company's loans are commercial real estate loans which includes construction loans. Approximately 12% of the Company's loans are for general commercial uses including professional, retail, and small business. Additionally, 6% of the Company's loans are for residential real estate and other consumer loans. The remaining 4% are agriculture loans.

Loan totals were as follows:

	DECEMBER 31,	
(in thousands)	2015	2014
Commercial real estate:		
Commercial real estate- construction	$19,363	$9,181
Commercial real estate- mortgages	363,644	315,506
Land	10,239	10,620
Farmland	29,801	23,091
Commercial and industrial	63,776	54,051
Consumer	774	805
Consumer residential	32,588	25,464
Agriculture	20,847	15,753
Total loans	541,032	454,471
Less:		
Net deferred loan fees/costs and fair value discount on acquired loans	(3,282)	(445)

Allowance for loan losses	(7,356)	(7,534)
Net loans	$530,394	$446,492

Loan Origination/Risk Management. The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. Once it is determined that the borrower's management possesses sound ethics and solid business acumen, the Company's management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Company avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Company also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans. At December 31, 2015, approximately 44.3% of the outstanding principal balance of the Company's commercial real estate loans were secured by owner-occupied properties.

With respect to loans to developers and builders that are secured by non-owner occupied properties that the Company may originate from time to time, the Company generally requires the borrower to have had an existing relationship with the Company and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

The Company originates consumer loans utilizing a computer-based credit scoring analysis to supplement the underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by line and staff personnel. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans follow bank policy, which include, but are not limited to, a maximum loan-to-value percentage of 80%, a maximum housing and total debt ratio of 36% and 42%, respectively and other specified credit and documentation requirements.

The Company maintains an independent loan review department that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

Purchased Credit-Impaired ("PCI") Loans. We evaluated loans purchased in the Acquisition in accordance with accounting guidance in ASC 310-30 related to loans acquired with deteriorated credit quality. Acquired loans are considered credit-impaired if there is evidence of significant deterioration of credit quality since origination and it is probable, at the acquisition date, that we will be unable to collect all contractually required payments receivable. Management has determined certain loans purchased in the MLB Acquisition to be PCI loans based on credit indicators such as nonaccrual status, past due status, loan risk grade, loan-to-value ratio, etc. Revolving credit agreements (e.g., home equity lines of credit and revolving commercial loans) are not considered PCI loans as cash flows cannot be reasonably estimated.

For acquired loans not considered credit-impaired, the difference between the contractual amounts due (principal amount) and the fair value is accounted for subsequently through accretion. We recognize discount accretion based on the acquired loan's contractual cash flows using an effective interest rate method. The accretion is recognized through the net interest margin.

The following table presents the fair value of purchased credit-impaired and other loans acquired from Mother Lode Bank as of the acquisition date:

(in thousands)	December 23, 2015 Purchased credit-impaired loans	Other purchased loans	Total
Contractually required payments including interest	$1,982	$ 44,007	$45,989
Less: nonaccretable difference	(1,103)	0	(1,103)
Cash flows expected to be collected (undiscounted)	879	44,007	44,886
Accretable yield	(14)	(2,041)	(2,055)
Fair value of purchased loans	$865	$ 41,966	$42,831

For the PCI loans, the accretable yield represents the excess of the cash flows expected to be collected at acquisition over the fair value of the loans at the acquisition date, and is accreted into interest income over the estimated remaining life of the purchased credit-impaired loans using the effective yield method, provided that the timing and amount of future cash flows is reasonably estimable. The cash flows expected to be collected are updated each quarter based on current assumptions regarding default rates, loss severities, and other factors that are reflective of current market conditions. Probable decreases in expected cash flows after acquisition result in the recognition of impairment as a specific allowance for loan losses or a charge-off to the allowance. The nonaccretable difference represents the difference between the undiscounted contractual cash flows and the undiscounted expected cash flows, and also reflects the estimated credit losses in the acquired loan portfolio at the acquisition date and can fluctuate due to changes in expected cash flows during the life of the PCI loans. Due to the timing of the Acquisition being near December 31, 2015, the accretable yield at Acquisition approximates the accretable yield at December 31, 2015.

Non-Accrual and Past Due Loans. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management’s opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Year-end non-accrual loans, segregated by class of loans, were as follows:

(in thousands)	YEAR ENDED DECEMBER 31, 2015	2014
Commercial real estate:		
Commercial real estate- construction	$0	$0
Commercial real estate- mortgages	0	1,296
Land	2,739	2,995
Farmland	51	72
Commercial and industrial	322	337
Consumer	0	0
Consumer residential	0	0
Agriculture	2,704	0
Total non-accrual loans	$5,816	$4,700

(1) Excluded from the above non-accrual loan table are Purchased Credit Impaired loans acquired in the MLB Acquisition.

Had non-accrual loans performed in accordance with their original contract terms, the Company would have recognized additional interest income of approximately $376,000 in 2015 and $321,000 in 2014.

The following table analyzes past due loans including the non-accrual loans in the above table, segregated by class of loans, as of December 31, 2015 (in thousands):

December 31, 2015	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Purchased Credit Impaired Loans	Total	Greater Than 90 Days Past Due and Still Accruing
Commercial real estate:								
Commercial R.E. - construction	$0	$0	$0	$0	$19,363	$ 0	$19,363	$ 0
Commercial R.E. – mortgages	0	0	0	0	363,526	118	363,644	0
Land	0	0	2,261	2,261	7,709	269	10,239	0
Farmland	1,182	0	51	1,233	28,568	0	29,801	0
Commercial and industrial	352	0	312	664	62,634	478	63,776	0
Consumer	0	0	0	0	774	0	774	0
Consumer residential	0	0	0	0	32,588	0	32,588	0
Agriculture	0	2,704	0	2,704	18,143	0	20,847	0
Total	$1,534	$2,704	$2,624	$6,862	$533,305	$ 865	$541,032	$ 0

The following table analyzes past due loans including the non-accrual loans in the above table, segregated by class of loans, as of December 31, 2014 (in thousands):

December 31, 2014	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90	Total Past Due	Current	Total	Greater Than 90 Days Past

			Days Past Due				Due and Still Accruing
Commercial real estate:							
Commercial R.E. - construction	$ 0	$ 0	$ 0	$ 0	$ 9,181	$ 9,181	$ 0
Commercial R.E. - mortgages	35	1,296	0	1,331	314,175	315,506	0
Land	0	0	2,493	2,493	8,127	10,620	0
Farmland	0	0	72	72	23,019	23,091	0
Commercial and industrial	14	0	323	337	53,714	54,051	0
Consumer	0	0	0	0	805	805	0
Consumer residential	0	0	0	0	25,464	25,464	0
Agriculture	0	0	0	0	15,753	15,753	0
Total	$ 49	$ 1,296	$ 2,888	$ 4,233	$ 450,238	$ 454,471	$ 0

Impaired Loans. Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Impaired loans by class as of December 31, 2015 and 2014 are set forth in the following tables. PCI loans are excluded from the 2015 table, as they have not experienced post acquisition declines in cash flows expected to be collected. No interest income was recognized on impaired loans subsequent to their classification as impaired during 2015 and 2014.

(in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
December 31, 2015						
Commercial real estate:						
Commercial R.E. - construction	$ 0	$ 0	$ 0	$ 0	$ 0	0
Commercial R.E. - mortgages	0	0	0	0	0	301
Land	3,856	0	2,739	2,739	722	2,914
Farmland	63	51	0	51	0	61
Commercial and Industrial	357	322	0	322	0	611
Consumer	0	0	0	0	0	0
Consumer residential	0	0	0	0	0	0
Agriculture	2,704	2,704	0	2,704	0	7
Total	$ 6,980	$ 3,077	$ 2,739	$ 5,816	$ 722	3,894

(in thousands)	Unpaid Contractual Principal	Recorded Investment With No	Recorded Investment With	Total Recorded Investment	Related Allowance	Average Recorded Investment

	Balance	Allowance	Allowance			
December 31, 2014						
Commercial real estate:						
Commercial R.E. - construction	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Commercial R.E. - mortgages	1,301	0	1,296	1,296	125	554
Land	3,215	0	2,995	2,995	868	3,155
Farmland	80	72	0	72	0	82
Commercial and Industrial	359	337	0	337	0	304
Consumer	0	0	0	0	0	0
Consumer residential	0	0	0	0	0	0
Agriculture	0	0	0	0	0	0
Total	$ 4,956	$ 408	$ 4,291	$ 4,700	$ 993	$ 4,096

Troubled Debt Restructurings – In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company's internal underwriting policy.

At December 31, 2015, there were 5 loans that were considered to be troubled debt restructurings, all of which are considered non-accrual totaling $3,060,000. At December 31, 2014, there were 5 loans that were considered to be troubled debt restructurings, all of which are considered non-accrual totaling $3,331,000. There were no unfunded commitments on TDR loans at December 31, 2015 and 2014. We have allocated $722,000 and $993,000 of specific reserves to loans whose terms have been modified in troubled debt restructurings as of December 31, 2015 and 2014, respectively.

During the year ended December 31, 2015 the terms of two loans were modified as troubled debt restructurings, as compared to four loans during 2014. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date; or a temporary payment modification in which the payment amount allocated towards principal was reduced. In some cases, a permanent reduction of the accrued interest on the loan was conceded.

The following table presents loans by class modified as troubled debt restructurings that occurred during the years ended December 31, 2015 and 2014:

(dollars in thousands)	For the Year Ended December 31, 2015			For the Year Ended December 31, 2014		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial real estate:						
Commercial R.E. - construction	0	$ 0	$ 0	0	$ 0	$ 0
Commercial R.E. - mortgages	0	0	0	0	0	0
Land	1	570	570	3	3,107	3,107
Farmland	0	0	0	0	0	0

Commercial and industrial	1		24		24	1		331		331
Consumer	0		0		0	0		0		0
Consumer residential	0		0		0	0		0		0
Agriculture	0		0		0	0		0		0
Total	2	$	594	$	594	4	$	3,438	$	3,438

The troubled debt restructurings during the years ended December 31, 2015 and 2014 did not increase the allowance for loan losses as a result of the loan modification and there were no charge offs as a result of the loan modifications.

There were no loans modified as troubled debt restructurings during the years ended December 31, 2015 and 2014 that had payment defaults during each respective year.

A loan is considered to be in payment default once it is ninety days contractually past due under the modified terms.

Quality ratings (Risk Grades) are assigned to all commitments and stand-alone notes. Risk grades define the basic characteristics of commitments or stand-alone note in relation to their risk. All loans are graded using a system that maximizes the loan quality information contained in loan review grades, while ensuring that the system is compatible with the grades used by bank examiners.

We grade loans using the following letter system:

1 Exceptional Loan

2 Quality Loan

3A Better Than Acceptable Loan

3B Acceptable Loan

3C Marginally Acceptable Loan

4 (W) Watch Acceptable Loan

5 Other Loans Especially Mentioned

6 Substandard Loan

7 Doubtful Loan

8 Loss

1. Exceptional Loan - Loans with A+ credits that contain very little, if any, risk. Grade 1 loans are considered Pass. To qualify for this rating, the following characteristics must be present:

-A high level of liquidity and whose debt-servicing capacity exceeds expected obligations by a substantial margin.

-Where leverage is below average for the industry and earnings are consistent or growing without severe vulnerability to economic cycles.

-Also included in this rating (but not mandatory unless one or more of the preceding characteristics are missing) are loans that are fully secured and properly margined by our own time instruments or U.S. blue chip securities. To be properly margined cash collateral must be equal to, or greater than, 110% of the loan amount.

2. Quality Loan - Loans with excellent sources of repayment that conform in all respects to bank policy and regulatory requirements. These are also loans for which little repayment risk has been identified. No credit or collateral exceptions. Grade 2 loans are considered Pass. Other factors include:

-Unquestionable debt-servicing capacity to cover all obligations in the ordinary course of business from well-defined primary and secondary sources.

-Consistent strong earnings.

-A solid equity base.

3A. *Better than Acceptable Loan* - In the interest of better delineating the loan portfolio's true credit risk for reserve allocation, further granularity has been sought by splitting the grade 3 category into three classifications. The distinction between the three are bank-defined guidelines and represent a further refinement of the regulatory definition of a pass, or grade 3 loan. Grade 3A is the stronger third of the pass category, but is not strong enough to be a grade 2 and is characterized by:

-Strong earnings with no loss in last three years and ample cash flow to service all debt well above policy guidelines.

-Long term experienced management with depth and defined management succession.

-The loan has no exceptions to policy.

-Loan-to-value on real estate secured transactions is 10% to 20% less than policy guidelines.

-Very liquid balance sheet that may have cash available to pay off our loan completely.

-Little to no debt on balance sheet.

3B. *Acceptable Loan* - 3B loans are simply defined as all loans that are less qualified than 3A loans and are stronger than 3C loans. These loans are characterized by acceptable sources of repayment that conform to bank policy and regulatory requirements. Repayment risks are acceptable for these loans. Credit or collateral exceptions are minimal, are in the process of correction, and do not represent repayment risk. These loans:

-Are those where the borrower has average financial strengths, a history of profitable operations and experienced management.

-Are those where the borrower can be expected to handle normal credit needs in a satisfactory manner.

3C. *Marginally Acceptable* - 3C loans have similar characteristics as that of 3Bs with the following additional characteristics:

Requires collateral. A credit facility where the borrower has average financial strengths, but usually lacks reliable secondary sources of repayment other than the subject collateral. Other common characteristics can include some or all of the following: minimal background experience of management, lacking continuity of management, a start-up operation, erratic historical profitability (acceptable reasons-well identified), lack of or marginal sponsorship of guarantor, and government guaranteed loans.

4W *Watch Acceptable* - Watch grade will be assigned to any credit that is adequately secured and performing but monitored for a number of indicators. These characteristics may include any unexpected short-term adverse financial performance from budgeted projections or prior period's results (i.e., declining profits, sales, margins, cash flow, or increased reliance on leverage, including adverse balance sheet ratios, trade debt issues, etc.). Additionally, any managerial or personal problems of company management, decline in the entire industry or local economic conditions failure to provide financial information or other documentation as requested; issues regarding delinquency, overdrafts, or renewals; and any other issues that cause concern for the company. Loans to individuals or loans supported by guarantors with marginal net worth and/or marginal collateral. Weakness identified

in a Watch credit is short-term in nature. Loans in this category are usually accounts the Company would want to retain providing a positive turnaround can be expected within a reasonable time frame. Grade 4 loans are considered Pass.

5 Other Loans Especially Mentioned (Special Mention) - A special mention extension of credit is defined as having potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may, at some future date result in the deterioration of the repayment prospects for the credit or the institution's credit position. Extensions of credit that might be detailed in this category include the following:

-The lending officer may be unable to properly supervise the credit because of an inadequate loan or credit agreement.

-Questions exist regarding the condition of and/or control over collateral.

-Economic or market conditions may unfavorably affect the obligor in the future.

-A declining trend in the obligor's operations or an imbalanced position in the balance sheet exists, but not to the point that repayment is jeopardized.

6 Substandard Loan - A "substandard" extension of credit is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Extensions of credit so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard credits, does not have to exist in individual extensions of credit classified substandard.

7 Doubtful Loan - An extension of credit classified "doubtful" has all the weaknesses inherent in one classified 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 that may work to the advantage of and strengthen the credit, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors may include a proposed merger or acquisition, liquidation proceedings, capital injection, perfecting liens on additional collateral or refinancing plans. The entire loan need not be classified doubtful when collection of a specific portion appears highly probable. An example of proper use of the doubtful category is the case of a company being liquidated, with the trustee-in-bankruptcy indicating a minimum disbursement of 40 percent and a maximum of 65 percent to unsecured creditors, including the Company. In this situation, estimates are based on liquidation value appraisals with actual values yet to be realized. By definition, the only portion of the credit that is doubtful is the 25 percent difference between 40 and 65 percent.

A proper classification of such a credit would show 40 percent substandard, 25 percent doubtful, and 35 percent loss. A credit classified as doubtful should be resolved within a 'reasonable' period of time. Reasonable is generally defined as the period between examinations. In other words, a credit classified doubtful at an examination should be cleared up before the next exam. However, there may be situations that warrant continuation of the doubtful classification a while longer.

8. Loss - Extensions of credit classified "loss" are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the credit has absolutely no recovery or

salvage value, but rather that it is not practical or desirable to defer writing off, even though partial recovery may be affected in the future. It should not be the Company’s practice to attempt long-term recoveries while the credit remains on the books. Losses should be taken in the period in which they surface as uncollectible.

As of December 31, 2015 and 2014, there are no loans that are classified with a risk grade of 8- Loss.

The following table presents weighted average risk grades of our loan portfolio.

	December 31, 2015 Weighted Average Risk Grade	December 31, 2014 Weighted Average Risk Grade
Commercial real estate:		
Commercial real estate - construction	3.72	3.00
Commercial real estate - mortgages	3.16	3.15
Land	4.58	4.34
Farmland	3.12	3.01
Commercial and industrial	3.57	3.39
Consumer	1.99	2.11
Consumer residential	3.01	3.02
Agriculture	3.39	3.18
Total gross loans	3.25	3.19

The following table presents risk grade totals by class of loans as of December 31, 2015 and 2014. Risk grades 1 through 4 have been aggregated in the "Pass" line.

(in thousands)	Commercial R.E. Construction	Commercial R.E. Mortgages	Land	Farmland	Commercial and Industrial	Consumer	Consumer Residential	Agriculture	Total
<u>December 31, 2015</u>									
Pass	$ 18,312	$ 357,339	$ 6,358	$ 28,568	$ 55,957	$ 745	$ 32,532	$ 18,143	$ 517,954
Special mention	-	4,389	110	-	6,153	-	-	-	10,652
Substandard	1,051	1,916	3,283	1,233	1,416	29	56	2,704	11,688
Doubtful	-	-	488	-	250	-	-	-	738
Total loans	$ 19,363	$ 363,644	$ 10,239	$ 29,801	$ 63,776	$ 774	$ 32,588	$ 20,847	$ 541,032

December 31, 2014									
Pass	$ 9,181	$ 310,912	$ 7,625	$ 23,019	$ 48,997	$ 790	$ 25,283	$ 15,753	$ 441,560
Special mention	-	2,722	-	-	3,438	-	-	-	6,160
Substandard	-	1,872	2,995	72	1,616	15	181	-	6,751
Doubtful	-	-	-	-	-	-	-	-	-
Total loans	$ 9,181	$ 315,506	$ 10,620	$ 23,091	$ 54,051	$ 805	$ 25,464	$ 15,753	$ 454,471

(1) Included in the table above is Purchased Credit Impaired loans at their fair value of $865,000, which were acquired in the MLB Acquisition.

Allowance for Loan Losses. The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Company's allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, "Receivables" and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Company's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision for loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including, among other things, the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Company's allowance for loan losses consists of three elements: (i) specific valuation allowances determined in accordance with ASC Topic 310 based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC Topic 450 based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted, as necessary, to reflect the impact of current conditions; and (iii) general valuation allowances determined in accordance with ASC Topic 450 based on general economic conditions and other qualitative risk factors both internal and external to the Company.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship manager level for all commercial loans. When a loan has a calculated grade of 5 or higher, a special assets officer analyzes the loan to determine whether the loan is impaired and, if impaired, the need to specifically allocate a portion of the allowance for loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower's ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower's industry, among other things.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans and the internal risk grade of such loans at the time they were charged-off. The Company calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool. The Company's pools of similar loans include similarly risk-graded groups of commercial and industrial loans, commercial real estate loans, consumer real estate loans and consumer and other loans.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the Company's lending management and staff; (ii) the effectiveness of the Company's loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the impact of competition on loan structuring and pricing; (vii) the effectiveness of the internal loan review function; (viii) the impact of environmental risks on portfolio risks; and (ix) the impact of rising interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. Each component is determined to have either a high, moderate or low degree of risk. The results are then input into a “general allocation matrix” to determine an appropriate general valuation allowance.

Included in the general valuation allowances are allocations for groups of similar loans with risk characteristics that exceed certain concentration limits established by management. Concentration risk limits have been established, among other things, for certain industry concentrations, large balance and highly leveraged credit relationships that exceed specified risk grades, and loans originated with policy exceptions that exceed specified risk grades.

Loans identified as losses by management, internal loan review and/or bank examiners are charged-off. Furthermore, consumer loan accounts are charged-off automatically based on regulatory requirements.

The following table details activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2015 and 2014. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

Allowance for Loan Losses

For the Year Ended December 31, 2015 and 2014

(in thousands)	Commercial Real Estate	Commercial and Industrial	Consumer	Consumer Residential	Agriculture	Unallocated	Total
Year Ended December 31, 2015							
Beginning balance	$ 5,963	$ 720	$ 42	$ 388	$ 286	$ 135	$7,534
Charge-offs	0	(32)	(30)	0	0	0	(62)
Recoveries	5	0	4	0	0	0	9
(Reversal of) provision for loan losses	(48)	(61)	22	38	23	(99)	(125)
Ending balance	$ 5,920	$ 627	$ 38	$ 426	$ 309	$ 36	$7,356
Year Ended December 31, 2014							
Beginning balance	$ 6,247	$ 663	$ 47	$ 440	$ 217	$ 45	$7,659
Charge-offs	(103)	0	(40)	0	0	0	(143)
Recoveries	1,882	0	2	11	0	0	1,895
(Reversal of) provision for loan losses	(2,063)	57	33	(63)	69	90	(1,877)
Ending balance	$ 5,963	$ 720	$ 42	$ 388	$ 286	$ 135	$7,534

The following table details the allowance for loan losses and ending gross loan balances as of December 31, 2015 and 2014, summarized by collective and individual evaluation methods of impairment.

(in thousands)

December 31, 2015	Commercial Real Estate	Commercial and Industrial	Consumer	Consumer Residential	Agriculture	Unallocated	Total
Allowance for loan losses for loans:							
Individually evaluated for impairment	$ 722	$ 0	$ 0	$ 0	$ 0		$ 722
Collectively evaluated for impairment	5,198	627	38	426	309	36	6,634
	$ 5,920	$ 627	$ 38	$ 426	$ 309	$ 36	$ 7,356
Ending gross loan balances:							
Individually evaluated for impairment	$ 2,790	$ 322	$ 0	$ 0	$ 2,704	$ 0	$ 5,816
Individually evaluated purchased credit impaired loans	387	478	0	0	0	0	865
Collectively evaluated for impairment	419,868	62,976	774	32,588	18,143	0	534,351
	$ 423,047	$ 63,776	$ 774	$ 32,588	$ 20,847	$ 0	$ 541,032
December 31, 2014							
Allowance for loan losses for loans:							
Individually evaluated for impairment	$ 993	$ 0	$ 0	$ 0	$ 0	$ 0	$ 993
Collectively evaluated for impairment	4,970	720	42	388	286	135	6,541
	$ 5,963	$ 720	$ 42	$ 388	$ 286	$ 135	$ 7,534
Ending balances of loans:							
Individually evaluated for impairment	$ 4,363	$ 337	$ 0	$ 0	$ 0	$ 0	$ 4,700
Collectively evaluated for impairment	354,035	53,714	805	25,464	15,753	0	449,771
	$ 358,398	$ 54,051	$ 805	$ 25,464	$ 15,753	$ 0	$ 454,471

Changes in the allowance off-balance-sheet commitments were as follows:

(in thousands)	**YEARS ENDED DECEMBER 31,**	
	2015	**2014**
Balance, beginning of year	$ 218	$ 134
Provision charged to operations for off balance sheet	7	84
Acquired balance from Mother Lode Bank (fair value)	13	0
Balance, end of year	$ 238	$ 218

The method for calculating the reserve for off-balance-sheet loan commitments is based on a reserve percentage which is less than other outstanding loan types because they are at a lower risk level. This reserve percentage, based on many factors including historical losses and existing economic conditions, is evaluated by management periodically and is applied to the total undisbursed loan commitment balance to calculate the reserve for off-balance-sheet commitments. Reserves for off-balance-sheet commitments are recorded in interest payable and other liabilities on the consolidated balance sheets.

At December 31, 2015 and 2014, loans carried at $541,032,000 and $454,471,000, respectively, were pledged as collateral on advances from the Federal Home Loan Bank.

NOTE 6 — PREMISES AND EQUIPMENT

Major classifications of premises and equipment are summarized as follows:

(in thousands)	**DECEMBER 31,**	
	2015	**2014**
Land	$4,755	$4,755
Building	8,939	8,667
Leasehold improvements	4,135	3,672

Furniture, fixtures, and equipment	7,132	6,479
	24,961	23,573
Less accumulated depreciation and amortization	(10,684)	(9,507)
	$14,277	$14,066

Depreciation expense was $1,207,000 and $1,174,000 and for the years ended December 31, 2015 and 2014, respectively.

NOTE 7 — INTEREST RECEIVABLE AND OTHER ASSETS

Other assets are summarized as follows:

(in thousands)	DECEMBER 31, 2015	DECEMBER 31, 2014
Interest income receivable on loans	$1,495	$1,271
Interest income receivable on investments	925	753
Net deferred tax asset	5,439	2,614
Federal Reserve Bank stock	758	758
Federal Home Loan Bank stock	2,958	2,517
Cash surrender value of life insurance	13,747	13,545
Investment in limited partnership	388	455
Goodwill	662	0
Core deposit intangible	1,031	0
Prepaid expenses and other	749	2,016
	$28,152	$22,658

NOTE 8 — DEPOSITS

Deposit totals were as follows:

(in thousands)	DECEMBER 31, 2015	DECEMBER 31, 2014
Demand	$279,367	$225,957
NOW accounts	130,674	108,374
Money market deposit accounts	282,449	247,442
Savings	71,627	39,412
Time, $250,000 and under	35,482	38,247
Time, over $250,000	15,092	10,149
Total deposits	$814,691	$669,581

Certificates of deposit issued and their remaining maturities at December 31, 2015, are as follows (in thousands):

Year ending December 31,	
2016	$38,295
2017	10,263
2018	1,793
2019	223
	$50,574

NOTE 9 — FHLB ADVANCES

At December 31, 2015, the Company had no outstanding advances from the Federal Home Loan Bank ("FHLB"). Unused and available advances totaled $198,415,000 at December 31, 2015. Loans carried at $541,032,000 as of December 31, 2015, were pledged as collateral on advances from the Federal Home Loan Bank.

At December 31, 2014, the Company had no outstanding advances from the Federal Home Loan Bank ("FHLB"). Unused and available advances totaled $176,689,000 at December 31, 2014. Loans carried at $454,471,000 as of December 31, 2014, were pledged as collateral on advances from the Federal Home Loan Bank.

NOTE 10 — INTEREST ON DEPOSITS

Interest on deposits was comprised of the following:

	YEARS ENDED DECEMBER 31,	
(in thousands)	**2015**	**2014**
Savings and other deposits	$ 423	$ 396
Time deposits over $250,000	26	32
Other time deposits	166	219
	$ 615	$ 647

NOTE 11 — INCOME TAXES

The provision for income taxes consists of the following:

(in thousands)	**YEARS ENDED DECEMBER 31,**	
	2015	**2014**
Current		
Federal	$1,498	$2,757
State	521	1,004
	2,019	3,761
Deferred		
Federal	64	(185)
State	(29)	(2)
	35	(187)
	$2,054	$3,574

The components of the Company's deferred tax assets and liabilities (included in accrued interest and other assets on the consolidated balance sheets, is shown below:

(in thousands)	**DECEMBER 31, 2015**	**2014**
Deferred tax assets:		
Allowance for loan losses	$3,033	$3,100
Fair value discount on acquired loans	1,218	0
Acquired net operating loss	1,587	0
Restricted stock expense	50	38
Accrued vacation	72	53
Accrued salary continuation liability	1,004	914
Deferred compensation	110	109
Nonaccrual loans	213	140
Reserve for undisbursed commitments	92	90
OREO expenses	492	254
Investment in limited partnership	0	(1)
State income tax	245	353
Holding company organization fees	30	34
	8,146	5,084
Deferred tax liabilities:		
Prepaid expenses	(98)	(73)
FHLB dividends	(220)	(220)
Accumulated depreciation	(505)	(609)
Deferred loan costs	(361)	(259)
Accrued bonus	(2)	(3)
Core deposit intangible	(424)	0
Unrealized gain on securities available for sale	(1,097)	(1,306)
	(2,707)	(2,470)
Net deferred income tax asset	$5,439	$2,614

As a result of the recent acquisition of MLB, the Company has included in its deferred tax asset usable net operating loss carryforwards in the federal and California jurisdictions of $3.8 million, which begin to expire in 2025 and 2028, respectively. The amount of carryforwards that may be utilized in each jurisdiction annually is limited to $191,000 per year under Sections 382 of the Internal Revenue Code due to the change in control. As the result of limitations under Section 382, $2.4 million and $1.9MM of the Company's federal and California net operating losses are expected to expire unused and have been excluded from the deferred tax asset.

Management has assessed the realizability of deferred tax assets and believes it is more likely than not that all deferred tax assets will be realized in the normal course of operations. Accordingly, these assets have not been reduced by a valuation allowance.

The Company periodically reviews its income tax positions based on tax laws and regulations and financial reporting considerations, and records adjustments as appropriate. This review takes into consideration the status of current taxing authorities' examinations of the Company's tax returns, recent positions taken by the taxing authorities on similar transactions, if any, and the overall tax environment.

During 2015, the Company settled the exams for the tax years of 2010, 2011, 2012 and 2013 with the California Franchise Tax Board ("FTB") by submitting a payment of $332,000. The net impact of this payment after the federal deduction was $219,000 and therefore resulted in a reversal of $83,000 to tax expense to clear the unrecognized tax benefit liability account of $302,000 as described below. The Company had no liabilities for unrecognized tax benefits as of December 31, 2015.

As of December 31, 2014, the Company had a liability for unrecognized tax benefits of $302,000 associated with the FTB potential exam of our 2010, 2011, 2012 and 2013 tax returns, approximately $51,000 of which relates to interest. The Company believes the $302,000 accrued liability is an adequate reserve for the potential of an exam for the 2010, 2011, 2012 and 2013 tax returns. There were no unrecognized tax benefit during 2014, as the entire $302,000 liability relates to prior years.

Detailed below is a reconciliation of the Company's unrecognized tax benefits, gross of any related tax benefits, for the year ended December 31, 2015 and 2014:

	Years Ended December 31,	
	2015	**2014**
Beginning balance	$302	$302
Payments to FTB to settle tax exams, net of federal deduction	(219)	0
Reversal of unrecognized tax benefits to income tax expense	(83)	0
Ending balance	$0	$302

The effective tax rate for 2015 and 2014 differs from the current Federal statutory income tax rate as follows:

	YEARS ENDED DECEMBER 31,	
	2015	**2014**
Federal statutory income tax rate	34.0 %	34.0 %
State taxes, net of federal tax benefit	7.2 %	7.2 %
Tax exempt interest on municipal securities and loans	-8.7 %	-4.7 %
Tax exempt earnings on bank owned life insurance	-2.5 %	-1.7 %
Reversal of reserve for tax exams	-1.2 %	0.0 %
Low income housing tax credit	-0.9 %	-0.6 %
California enterprise zone tax credits and deductions	-0.5 %	-0.4 %
Non-deductible merger expenses	2.4 %	0.0 %
Other	-0.2 %	0.2 %
Effective tax rate	29.5 %	33.4 %

Oak Valley Bancorp files a consolidated return in the U.S. Federal tax jurisdiction and a combined report in the State of California tax jurisdiction. None of the entities are subject to examination by taxing authorities for years before 2012 for U.S. Federal or for years before 2011 for California.

NOTE 12 — STOCK OPTION PLAN

The Company currently has two equity based incentive plans, the Oak Valley Community Bank 1998 Restated Stock Option Plan and the Oak Valley Bancorp 2008 Stock Plan. The 2008 Stock Plan provides for awards in the form of incentive stocks, non-statutory stock options, stock appreciation rights and restrictive stocks. Under the 2008 Plan, the Company is authorized to issue 1,500,000 shares of its common stock to key employees and directors as incentive and non-qualified stock options, respectively, at a price equal to the fair value on the date of grant. The Plan provides that the options are exercisable in equal increments over a five-year period from the date of grant or over any other schedule approved by the Board of Directors. All incentive stock options expire no later than ten years from the date of grant. Future grants are not permitted under the 1998 Stock Plan and will all be issued from the 2008 Stock Plan.

A summary of the status of the Company's stock option plan and changes during the year are presented below.

	DECEMBER 31, 2015	
	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	67,500	$ 12.57
Granted	0	$ 0.00
Exercised	0	$ 0.00
Forfeited	(34,500)	$ 12.98
Outstanding at end of year	33,000	$ 12.13

A summary of the status of the Company's restricted stock and changes during the year are presented below.

	DECEMBER 31, 2015	
	Shares	Weighted-Average

		Grant Date Fair Value
Unvested at beginning of year	114,747	$ 7.36
Granted	6,000	$ 9.64
Vested	(36,536)	$ 7.18
Cancelled	(2,700)	$ 8.05
Unvested at end of year	81,511	$ 7.59

(dollars in thousands)	**December 31, 2015**	**2014**
Weighted-average fair value of options granted during the year	N/A	N/A
Intrinsic value of options exercised	N/A	$239
Options outstanding and exerciseable at year end:	33,000	67,500
Weighted average exercise price	$12.13	$12.57
Intrinsic value	$19	$17
Weighted average remaining contractual life (in years)	1.13	1.16

There were no tax benefits recorded in the consolidated statements of income during 2015 and 2014 related to the vesting of non-qualified stock options. As of December 31, 2015, there was no unrecognized compensation cost related to non-vested stock options.

For the year ended December 31, 2015, there were no exercises of stock options and therefore no income tax benefits related to disqualifying dispositions. All outstanding stock options became fully vested during 2014 and therefore there was no recognition of stock option compensation expense in the consolidated statements of income in 2015.

The Company granted 6,000 shares of restricted stock in 2015 with a weighted average fair value of $9.64 per share. For the year ended December 31, 2015, total compensation expense recorded in the consolidated statements of income related to restricted stock awards was $261,000, with an offsetting tax benefit of $107,000, as this expense is deductible for income tax purposes. The Company recorded an additional tax benefit of $46,000 to paid-in capital to recognize the full tax deduction of the vested restricted stock, which is equal to the fair value on the vesting date, as the tax benefit recognized in the consolidated statements of income is based on the grant date fair value. As of December 31, 2015, there was $412,000 of total unrecognized compensation cost related to restricted stock awards which is expected to be recognized over a weighted-average period of 2.24 years. During 2015, shares of restricted stock awards totaling 36,536 with a fair value of $345,000 were vested and became unrestricted.

For the year ended December 31, 2014, the Company received proceeds of approximately $924,000 from the exercise of stock options and received income tax benefits of approximately $88,000 related to disqualifying dispositions in the exercise of incentive stock options. During 2014, the Company recorded $1,000 in the consolidated statements of income related to stock option compensation expense.

The Company granted 24,500 shares of restricted stock in 2014 with a weighted average fair value of $9.44 per share. For the year ended December 31, 2014, total compensation expense recorded in the consolidated statements of income related to restricted stock awards was $271,000, with an offsetting tax benefit of $111,000, as this expense is deductible for income tax purposes. The Company recorded an additional tax benefit of $30,000 to paid-in capital to recognize the full tax deduction of the vested restricted stock, which is equal to the fair value on the vesting date, as the tax benefit recognized in the consolidated statements of income is based on the grant date fair value. As of December 31, 2014, there was $636,000 of total unrecognized compensation cost related to restricted stock awards which is expected to be recognized over a weighted-average period of 2.81 years. During 2014, shares of restricted stock awards totaling 34,236 with a fair value of $306,000 were vested and became unrestricted.

NOTE 13 — EARNINGS PER SHARE

Earnings per share (“EPS”) are based upon the weighted average number of common shares outstanding during each year. The following table shows: (1) weighted average basic shares, (2) effect of dilutive securities related to stock options and non-vested restricted stock, and (3) weighted average diluted shares. Net income is calculated as net income reduced by dividends accumulated on preferred stock. Basic EPS are calculated by dividing net income by the weighted average number of common shares outstanding during each period, excluding unvested restricted stock awards. Diluted EPS are calculated using the weighted average diluted shares. The total dilutive shares included in annual diluted EPS is a year-to-date weighted average of the total dilutive shares included in each quarterly diluted EPS computation under the treasury stock method. We have two forms of outstanding common stock: common stock and unvested restricted stock awards. Holders of restricted stock awards receive non-forfeitable dividends at the same rate as common stockholders and they both share equally in undistributed earnings. Therefore, under the two class method the difference in EPS is not significant for these participating securities.

The Company's calculation of earnings per share ("EPS") including basic EPS, which does not consider the effect of common stock equivalents and diluted EPS, which considers all dilutive common stock equivalents is as follows:

	YEAR ENDED DECEMBER 31, 2015		
	Income (Numerator)	**Shares (Denominator)**	**Per-Share Amount**
Basic EPS:			
Net income	$4,908	7,989,088	$ 0.61
Effect of dilutive securities:			
Stock options	—	1,399	
Non-vested restricted stock	—	46,358	
Total dilutive shares		47,757	
Diluted EPS:			
Net income per diluted share	$4,908	8,036,845	$ 0.61

Anti-dilutive options to purchase 47,784 and 63,815 shares of common stock in prices ranging from $9.95 to $15.67 were outstanding during 2015 and 2014, respectively. They were not included in the computation of diluted EPS because the options’ exercise price was greater than the average market price of the common shares. These options began to expire in 2015.

During 2015 and 2014, there were no anti-dilutive shares from non-vested restricted stock grants because the fair value of each grant was lower than the average market price of the common shares.

	YEAR ENDED DECEMBER 31, 2014		
(dollars in thousands)	**Income (Numerator)**	**Shares (Denominator)**	**Per-Share Amount**
Basic EPS:			
Net income	$7,122	7,938,052	$ 0.90
Effect of dilutive securities:			
Stock options	—	4,822	
Non-vested restricted stock	—	49,857	
Total dilutive shares		54,679	
Diluted EPS:			
Net income per diluted share	$7,122	7,992,731	$ 0.89

NOTE 14 — COMMITMENTS AND CONTINGENCIES

The Company is obligated for rental payments under certain operating lease agreements, some of which contain renewal options and escalation clauses that provide for increased rentals. Total rental expense for the years ended December 31, 2015 and 2014, was $874,000 and $816,000, respectively.

At December 31, 2015, the future minimum commitments under these operating leases are as follows (in thousands):

Year ending December 31,	
2016	$911
2017	865
2018	795
2019	765
2020	666
Thereafter	2,453
	$6,455

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit in the form of loans or through standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the balance sheet. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Financial instruments at December 31, 2015 whose contract amounts represent credit risk:

(in thousands)	**Contract Amount**
Undisbursed loan commitments	$ 74,654
Checking reserve	1,235
Equity lines	14,219
Standby letters of credit	1,623
	$ 91,731

Commitments to extend credit, including undisbursed loan commitments and equity lines, are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer’s creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management’s credit evaluation. Collateral held varies but may include accounts receivable, inventory, property, plant, equipment and income-producing commercial properties.

Checking reserves are lines of credit associated consumer deposit accounts that meet qualification standards for extension of credit if the deposit account were to become overdraft.

Standby letters of credit are conditional commitments 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 loan facilities to customers.

NOTE 15 — FINANCIAL INSTRUMENTS

Fair values of financial instruments — The consolidated financial statements include various estimated fair value information as of December 31, 2015 and 2014. Such information, which pertains to the Company’s financial instruments, does not purport to represent the aggregate net fair value of the Company. Further, the fair value estimates are based on various assumptions, methodologies, and subjective considerations, which vary widely among different financial institutions and which are subject to change. The following methods and assumptions are used by the Company.

Cash and cash equivalents — The carrying amounts of cash and cash equivalents approximate their fair value.

Restricted Equity Securities — The carrying amounts of the stock the Company's owns in FRB and FHLB approximate their fair value and are considered a level 2 valuation.

Securities (including mortgage-backed securities) — Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. See Note 16 for additional disclosure regarding fair values of securities.

Loans receivable — For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. The fair values for other loans (e.g., real estate construction and mortgage, commercial, and installment loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The allowance for loan losses is considered to be a reasonable estimate of loan discount due to credit risks.

Deposit liabilities — The fair values estimated for demand deposits (interest and non-interest checking, savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). The carrying amounts for variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of the aggregate expected monthly maturities on time deposits.

Interest receivable and payable — The carrying amounts of accrued interest approximate their fair value.

Off-balance-sheet instruments — Fair values for the Company's off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the credit standing of the counterparties.

The estimated fair values of the Company's financial instruments at December 31, 2015 were as follows:

(in thousands)	**Carrying Amount**	**Fair Value**	**Hierarchy Valuation** Level
Financial assets:			
Cash and cash equivalents	$190,603	$190,603	1
Restricted equity securities	3,716	3,716	2
Loans, net	530,394	537,761	3
Interest receivable	2,420	2,420	2
Financial liabilities:			
Deposits	(814,691)	(725,982)	3
Interest payable	(36)	(36)	2
Off-balance-sheet assets (liabilities):			
Commitments and standby letters of credit		(917)	3

The estimated fair values of the Company's financial instruments at December 31, 2014 were as follows:

(in thousands)	**Carrying Amount**	**Fair Value**	**Hierarchy Valuation** Level
Financial assets:			
Cash and cash equivalents	$144,288	$144,288	1
Restricted equity securities	3,275	3,275	2

Loans, net	446,492	455,501	3
Interest receivable	2,024	2,024	2
Financial liabilities:			
Deposits	(669,581)	(600,941)	3
Interest payable	(39)	(39)	2
Off-balance-sheet assets (liabilities):			
Commitments and standby letters of credit		(848)	3

NOTE 16 – FAIR VALUE MEASUREMENTS

ASC Topic 820, Fair Value Measurements, defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follow:

Level 1: Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstance that caused the transfer, which generally corresponds with the Company's quarterly valuation process. During 2015, there were no transfers between levels of the fair value hierarchy.

Assets and liabilities measured at fair value on a recurring and non-recurring basis for the years ended December 31, 2015 and 2014 are summarized below:

(in thousands)	**Fair Value Measurements at December 31, 2015 Using**			
	December 31, 2015	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets and liabilities measured on a recurring basis:				
Available-for-sale securities				
U.S. agencies	$32,868	$ 0	$ 31,815	$ 0
Collateralized mortgage obligations	2,719	0	2,729	0
Municipalities	68,586	0	66,535	0
SBA pools	806	0	811	0
Corporate debt	13,420	0	10,944	2,476
Asset backed securities	10,138	0	10,321	0
Mutual fund	3,009	3,172	0	0
Assets and liabilities measured on a non-recurring basis:				
Impaired loans:				
Land	$1,965	$ 0	$ 0	$ 1,965
Other real estate owned	$2,066	$ 0	$ 0	$ 2,066

(in thousands)	Fair Value Measurements at December 31, 2014 Using			
	December 31, 2014	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets and liabilities measured on a recurring basis:				
Available-for-sale securities				
U.S. agencies	$41,930	$ 0	$ 41,930	$ 0
Collateralized mortgage obligations	7,072	0	7,072	0
Municipalities	50,897	0	50,897	0
SBA pools	892	0	892	0
Corporate debt	6,804	0	6,804	0
Asset backed securities	10,710	0	10,710	0
Mutual fund	2,972	2,972	0	0
Assets and liabilities measured on a non-recurring basis:				
Impaired loans:				
Land	$1,743	$ 0	$ 0	$ 1,743
Commercial real estate - mortgages	$1,171	$ 0	$ 0	$ 1,171
Other real estate owned	$884	$ 0	$ 0	$ 884

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

Available-for-sale securities - Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, if available. If quoted market prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions, and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Impaired loans - ASC Topic 820 applies to loans measured for impairment using the practical expedients permitted by ASC Topic 310, Accounting by Creditors for Impairment of a Loan. The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Impaired loans where an allowance is established based on the fair value of collateral less the cost related to liquidation of the collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as non-recurring Level 3. Likewise, when an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as non-recurring Level 3.

Other Real Estate Owned - Other real estate assets (“OREO”) acquired through, or in lieu of, foreclosure are held-for-sale and are initially recorded at the lower of cost or fair value, less selling costs. Any write-downs to fair value at the time of transfer to OREO are charged to the allowance for loan losses, subsequent to foreclosure. Appraisals or evaluations are then done periodically thereafter charging any additional write-downs or valuation allowances to the appropriate expense accounts. Values are derived from appraisals of underlying collateral and discounted cash flow analysis. OREO is classified within Level 3 of the hierarchy.

Net realizable value of the underlying collateral is the fair value of the collateral less estimated selling costs and any prior liens. Appraisals, recent comparable sales, offers and listing prices are factored in when valuing the collateral. We review and verify the qualifications and licenses of the certified general appraisers used for appraising commercial properties or certified residential appraisers for residential properties. Real estate appraisals may utilize a combination of approaches including replacement cost, sales comparison and the income approach. Comparable sales and income data are analyzed by the appraisers and adjusted to reflect differences between them and the subject property such as type, leasing status and physical condition. When the appraisals are received, Management reviews the assumptions and methodology utilized in the appraisal, as well as the overall resulting value in conjunction with independent data sources such as recent market data and industry-wide statistics. We generally use a 6% discount for selling costs which is applied to all properties, regardless of size. Appraised values may be adjusted to reflect changes in market conditions that have occurred subsequent to the appraisal date, or for revised estimates regarding the timing or cost of the property sale. These adjustments typically range between 10% and 20% of the appraised value and are based on qualitative judgments made by management on a case-by-case basis.

NOTE 17 — RELATED PARTY TRANSACTIONS

The Company, in the normal course of business, makes loans and receives deposits from its directors, officers, principal shareholders, and their associates. In management’s opinion, these transactions are on substantially the same terms as comparable transactions with other customers of the Company. Loans to directors, officers, shareholders, and affiliates are summarized below:

(in thousands)	**YEARS ENDED DECEMBER 31, 2015**	**2014**
Aggregate amount outstanding, beginning of year	$8,218	$13,684
New loans or advances during year	17,402	8,345
Repayments during year	(18,986)	(13,811)
Aggregate amount outstanding, end of year	$6,634	$8,218

Related party deposits totaled $62,727,000 and $58,446,000 at December 31, 2015 and 2014, respectively.

NOTE 18 — PROFIT SHARING PLAN

The profit sharing plan to which both the Company and eligible employees contribute was established in 1995. Bank contributions are voluntary and at the discretion of the Board of Directors. Contributions were approximately $454,000 and $371,000 for the years ended December 31, 2015 and 2014, respectively.

NOTE 19 — RESTRICTIONS ON DIVIDENDS

Under current California State banking laws, the Bank may not pay cash dividends in an amount that exceeds the lesser of retained earnings of the Bank or the Bank’s net earnings for its last three fiscal years (less the amount of any distributions to shareholders made during that period). If the above requirements are not met, cash dividends may only be paid with the prior approval of the Commissioner of the Department of Business Oversight, in an amount not exceeding the Bank’s net earnings for its last fiscal year or the amount of its net earnings for its current fiscal year. Accordingly, the future payment of cash dividends will depend on the Bank’s earnings and its ability to meet its capital requirements.

NOTE 20 — OTHER POST-RETIREMENT BENEFIT PLANS

The Company has awarded certain officers a salary continuation plan (the “Plan”). Under the Plan, the participants will be provided with a fixed annual retirement benefit for 20 years after retirement. The Company is also responsible for certain pre-retirement death benefits under the Plan. In connection with the implementation of the Plan, the Company purchased single premium life insurance policies on the life of each of the officers covered under the Plan. The Company is the owner and partial beneficiary of these life insurance policies. The assets of the Plan, under Internal Revenue Service regulations, are owned by the Company and are available to satisfy the Company’s general creditors.

During December 2001, the Company awarded its directors a director retirement plan (“DRP”). Under the DRP, the participants will be provided with a fixed annual retirement benefit for ten years after retirement. The Company is also responsible for certain pre-retirement death benefits under the DRP. In connection with the implementation of the DRP, the Company purchased single premium life insurance policies on the life of each director covered under the DRP. The Company is the owner and partial beneficiary of these life insurance policies. The assets of the DRP, under Internal Revenue Service regulations, are the property of the Company and are available to satisfy the Company’s general creditors.

Future compensation under both plans is earned for services rendered through retirement. The Company accrues for the salary continuation liability based on anticipated years of service and vesting schedules provided under the plans. The Company's current benefit liability is determined based on vesting and the present value of the benefits at a corresponding discount rate. The discount rate used is an equivalent rate for investment-grade bonds with lives matching those of the service periods remaining for the salary continuation contracts, which average approximately 20 years. At December 31, 2015 and 2014, $2,440,000 and $2,222,000, respectively, has been accrued to date, and is included in other liabilities on the consolidated balance sheets.

The Company entered into split-dollar life insurance agreements with certain officers. In connection with the implementation of the split-dollar agreements, the Company purchased single premium life insurance policies on the life of each of the officers covered by the split-dollar life insurance agreements. The Company is the owner of the policies and the partial beneficiary in an amount equal to the cash surrender value of the policies.

The combined cash surrender value of all Bank-owned life insurance policies was $13,747,000 and $13,545,000 at December 31, 2015 and 2014, respectively. The cash surrender value of the life insurance policies is included in other assets on the consolidated balance sheets (Note 7).

NOTE 21 — REGULATORY MATTERS

The Bank and the Company are subject to various regulatory capital requirements administered by federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory — and possibly additional discretionary — actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the table below) of total, Tier I and Common Equity Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2015, that the Bank and Company meets all capital adequacy requirements to which they are subject.

As of December 31, 2015, the most recent notification from the Federal Reserve Bank categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, Common Equity Tier 1 risk-based and Tier I leverage ratios as set forth in the following table. There are no conditions or events since notification that management believes have changed the Bank’s category.

The Company and Bank’s actual capital amounts and ratios at December 31, 2015 and 2014, are presented in the following table.

(in thousands)	Actual		For capital adequacy purposes		To be well capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Capital ratios for Bank:						
As of December 31, 2015						
Total capital (to Risk- Weighted Assets)	$81,462	12.2 %	$53,348	≥8.0 %	$66,685	≥10.0 %
Tier I capital (to Risk- Weighted Assets)	$73,868	11.1 %	$40,011	≥6.0 %	$53,348	≥8.0 %
Common equity Tier 1 capital (to Risk- Weighted Assets)	$73,868	11.1 %	$30,008	≥4.5 %	$43,345	≥6.5 %
Tier I capital (to Average Assets)	$73,868	9.1 %	$32,475	≥4.0 %	$40,593	≥5.0 %
As of December 31, 2014						
Total capital (to Risk- Weighted Assets)	$79,168	14.5 %	$43,778	≥8.0 %	$54,722	≥10.0 %
Tier I capital (to Risk- Weighted Assets)	$72,316	13.2 %	$21,889	≥4.0 %	$32,833	≥6.0 %
Tier I capital (to Average Assets)	$72,316	10.1 %	$28,783	≥4.0 %	$35,979	≥5.0 %
Capital ratios for Bancorp:						
As of December 31, 2015						
Total capital (to Risk- Weighted Assets)	$81,852	12.3 %	$53,353	≥8.0 %	N/A	N/A
Tier I capital (to Risk- Weighted Assets)	$74,258	11.1 %	$40,014	≥6.0 %	N/A	N/A
Common equity Tier 1 capital (to Risk- Weighted Assets)	$74,258	11.1 %	$30,011	≥4.5 %	N/A	N/A
Tier I capital (to Average Assets)	$74,258	9.2 %	$32,478	≥4.0 %	N/A	N/A
As of December 31, 2014						
Total capital (to Risk- Weighted Assets)	$79,873	14.5 %	$43,785	≥8.0 %	N/A	N/A
Tier I capital (to Risk- Weighted Assets)	$73,020	13.3 %	$21,893	≥4.0 %	N/A	N/A
Tier I capital (to Average Assets)	$73,020	10.2 %	$28,787	≥4.0 %	N/A	N/A

In July 2013, the U.S. banking agencies approved the U.S. version of Basel III. The federal bank regulatory agencies adopted version of Basel III revises the risk-based and leverage capital requirements and the method for calculating risk-weighted assets to make them consistent with Basel III and to meet the requirements of the Dodd-Frank Act. Although many of the rules contained in these final regulations are applicable only to large, internationally active banks, some of them will apply on a phased in basis to all banking organizations, including the Company and the Bank. Among other things, the rules establish a new minimum common equity Tier 1 ratio (4.5% of risk-weighted assets), a higher minimum Tier 1 risk-based capital requirement (6.0% of risk-weighted assets) and a minimum non-risk-based leverage ratio (4.00% eliminating a 3.00% exception for higher rated banks). The new additional capital conservation buffer of 2.5% of risk weighted assets over each of the required capital ratios will be phased in from 2016 to 2019 and must be met to avoid limitations on the ability of the Bank to pay dividends, repurchase shares or pay discretionary bonuses. The additional "countercyclical capital buffer" is also required for larger and more complex institutions. The new rules assign higher risk weighting to exposures that are more than 90 days past due or are on nonaccrual status and certain commercial real estate facilities that finance the acquisition, development or construction of real property. The rules also change the permitted composition of Tier 1 capital to exclude trust preferred securities, mortgage servicing rights and certain deferred tax assets and include unrealized gains and losses on available for sale debt and equity securities (with a one-time opt out option for Standardized Banks (banks with less than $250 billion of total consolidated assets and less than $10 billion of foreign exposures)). The rules, including alternative requirements for smaller community financial institutions like the Company, would be phased in through 2019. The implementation of the Basel III framework for the Company and the Bank commenced on January 1, 2015.

In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to total average assets, referred to as the leverage ratio. Banks that have received the highest rating of the five categories used by regulators to rate banks and are not anticipating or experiencing any significant growth must maintain a ratio of Tier 1 capital (net of all intangibles) to adjusted total assets, or "Leverage Capital Ratio", of at least 3%. All other institutions are required to maintain a leverage ratio of at least 100 to 200 basis points above the 3% minimum, for a minimum of 4% to 5%. Pursuant to federal regulations, banks must maintain capital levels commensurate with the level of risk to which they are exposed, including the volume and severity of problem loans.

OAK VALLEY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

22. PARENT ONLY CONDENSED FINANCIAL STATEMENTS

CONDENSED BALANCE SHEETS

(dollars in thousands)	**December 31, 2015**	**December 31, 2014**
ASSETS		
Cash	$ 359	$ 612
Investment in bank subsidiary	77,878	74,287
Other assets	109	142
Total assets	$ 78,346	$ 75,041
LIABILITIES AND SHAREHOLDERS' EQUITY		
Other liabilities	$ 83	$ -
Total liabilities	$ 83	$ -
Shareholders' equity		
Common stock, no par value; 50,000,000 shares authorized, 8,078,155 and 8,074,855 shares issued and outstanding at December 31, 2015 and 2014, respectively	24,682	24,682
Additional paid-in capital	3,217	2,910
Retained earnings	48,795	45,582
Accumulated other comprehensive income, net of tax	1,569	1,867
Total shareholders' equity	78,263	75,041
Total liabilities and shareholders' equity	$ 78,346	$ 75,041

OAK VALLEY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

22. PARENT ONLY CONDENSED FINANCIAL STATEMENTS (CONTINUED)

CONDENSED STATEMENTS OF INCOME

(dollars in thousands)	Year Ended December 31, 2015	2014
INCOME		
Dividends declared by subsidiary	$1,695	$793
Total income	1,695	793
EXPENSES		
Salary expense	94	75
Employee benefit expense	261	271
Legal expense	76	34
Other operating expenses	476	103
Total non-interest expense	907	483
Income before equity in undistributed income of subsidiary	788	310
Equity in undistributed net income of subsidiary	3,889	6,577
Income before income tax benefit	4,677	6,887
Income tax benefit	231	235
Net income	$4,908	$7,122

OAK VALLEY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

22. PARENT ONLY CONDENSED FINANCIAL STATEMENTS (CONTINUED)

CONDENSED STATEMENTS OF CASHFLOWS

(dollars in thousands)	**YEAR ENDED DECEMBER 31, 2015**	**2014**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$4,908	$7,122
Adjustments to reconcile net income to net cash from operating activities:		
Undistributed net income of subsidiary	(3,889)	(6,577)
Stock based compensation	261	271
Excess tax benefits from stock-based payment arrangements	(46)	(102)
Increase in other liabilities	83	0
Decrease (increase) in other assets	79	(17)
Net cash from operating activities	1,396	697
CASH FLOWS FROM FINANCING ACTIVITIES:		
Shareholder cash dividends paid	(1,695)	(1,318)
Proceeds from sale of common stock and exercise of stock options	0	924
Excess tax benefits from stock-based payment arrangements	46	102
Net cash used in financing activities	(1,649)	(292)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(253)	405
CASH AND CASH EQUIVALENTS, beginning of period	612	207
CASH AND CASH EQUIVALENTS, end of period	$359	$612
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Income taxes	$4,152	$3,005

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INDEX TO EXHIBITS

Exhibit Number	Description
2.1	Agreement and Plan of Merger between the Registrant, Interim Oak Valley Bancorp, Inc. and Oak Valley Community Bank*
3.1	Articles of Incorporation of Oak Valley Bancorp, Inc.*
3.2	First Amendment to Articles of Incorporation of Oak Valley Bancorp, Inc.*
3.3	Bylaws of Oak Valley Bancorp, Inc.*
3.4	First Amended and Restated Bylaws of Oak Valley Bancorp, Inc.**
3.5	Certificate of Determination of Series A Preferred Stock of Oak Valley Bancorp, Inc.**
3.6	Letter Agreement between the United States Department of the Treasury and Oak Valley Bancorp dated December 5, 2008**
3.7	Certificate of Amendment of Bylaws dated effective as of August 11, 2011****
3.8	Amendment of Bylaws incorporated by reference from the Form 8-K filed on July 22, 2013.
4.1	Certificate of Determination dated December 2, 2008 filed with the California Secretary of State for Fixed Rate Cumulative Perpetual Preferred Stock, Series A**
4.2	Warrant to Purchase Common Stock dated December 5, 2008**
4.3	Certificate of Determination dated August 11, 2011 and filed with the California Secretary of State for Senior Non-Cumulative Perpetual Preferred Stock, Series B****
10.1	Oak Valley Community Bank 1998 Restated Stock Option Plan*
10.2	Oak Valley Community Bank Form of Director Retirement Agreement*
10.3	Oak Valley Community Bank Form of Salary Continuation Agreement*
10.4	Securities Purchase Agreement between Oak Valley Bancorp and the U.S. Treasury effective December 4, 2008**
10.5	Securities Purchase Agreement dated August 11, 2011 between the Company and the Secretary of the U.S. Treasury, with respect to the issuance and sale of Senior Non-Cumulative Perpetual Preferred Stock, Series B.****
10.6	

	Warrant Redemption Letter Agreement dated September 28, 2011 between the Company and the U.S. Treasury, with respect to the redemption of the Warrant to Purchase Common Stock dated December 5, 2008.****
14	Code of Ethics***
21	Subsidiaries of the Issuer*
23.1	Consent of Independent Registered Accounting Firm
24	Power of Attorney (included on the signature page of this report)
31.01	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.02	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.01	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.01	XBLR Interactive Data File*****

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* Incorporated by reference from the Form 10 filed on July 31, 2008

** Incorporated by reference from the Form 8-A filed on January 14, 2009

*** Incorporated by reference from the Form 10-K filed on March 31, 2009

**** Incorporated by reference from the Form 10-Q filed on November 14, 2011

***** As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.