UNITED SECURITY BANCSHARES
Form 10-Q
August 04, 2016
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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2016

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

Commission file number: 000-32897

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

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

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

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).
Large accelerated filer o Accelerated filer o Non-accelerated filer o Small reporting company x

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

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

Common Stock, no par value
(Title of Class)

Shares outstanding as of July 31, 2016: 16,373,996

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PART I. Financial Information

United Security Bancshares and Subsidiaries
Consolidated Balance Sheets – (unaudited)
June 30, 2016 and December 31, 2015

(in thousands except shares)	June 30, 2016	December 31, 2015
Assets		
Cash and non-interest bearing deposits in other banks	$21,107	$ 29,733
Cash and due from Federal Reserve Bank	73,457	96,018
Cash and cash equivalents	94,564	125,751
Interest-bearing deposits in other banks	1,532	1,528
Investment securities available for sale (at fair value)	42,635	30,893
Loans	557,209	515,318
Unearned fees and unamortized loan origination costs, net	1,459	58
Allowance for credit losses	(8,909)	(9,713)
Net loans	549,759	505,663
Accrued interest receivable	3,138	2,220
Premises and equipment – net	10,414	10,800
Other real estate owned	7,454	12,873
Goodwill	4,488	4,488
Cash surrender value of life insurance	18,607	18,337
Investment in limited partnerships	910	917
Deferred tax assets - net	4,901	5,228
Other assets	5,668	6,946
Total assets	$744,070	$ 725,644
Liabilities & Shareholders' Equity		
Liabilities		
Deposits		
Noninterest bearing	$272,058	$ 262,168
Interest bearing	364,891	359,637
Total deposits	636,949	621,805
Accrued interest payable	28	29
Accounts payable and other liabilities	5,618	5,875
Junior subordinated debentures (at fair value)	7,837	8,300
Total liabilities	650,432	636,009
Shareholders' Equity		
Common stock, no par value 20,000,000 shares authorized, 16,373,996 issued and outstanding at June 30, 2016, and 16,051,406 at December 31, 2015	54,259	52,572
Retained earnings	39,382	37,265
Accumulated other comprehensive loss	(3)	(202)
Total shareholders' equity	93,638	89,635
Total liabilities and shareholders' equity	$744,070	$ 725,644

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

	Quarter Ended June 30,		Six Months Ended June 30,	
(In thousands except shares and EPS)	2016	2015	2016	2015
Interest Income:				
Loans, including fees	$6,658	$ 6,634	$13,288	$ 12,913
Investment securities – AFS – taxable	185	166	374	380
Interest on deposits in FRB	151	37	276	83
Interest on deposits in other banks	2	1	4	3
Total interest income	6,996	6,838	13,942	13,379
Interest Expense:				
Interest on deposits	272	253	549	512
Interest on other borrowings	58	59	116	117
Total interest expense	330	312	665	629
Net Interest Income	6,666	6,526	13,277	12,750
Provision (Recovery of Provision) for Credit Losses	12	(2)	(10)	457
Net Interest Income after (Recovery of Provision) Provision for Credit Losses	6,654	6,528	13,287	12,293
Noninterest Income:				
Customer service fees	1,017	866	1,943	1,699
Increase in cash surrender value of bank-owned life insurance	132	130	264	258
Gain on fair value of financial liability	113	324	471	199
Other	165	226	310	311
Total noninterest income	1,427	1,546	2,988	2,467
Noninterest Expense:				
Salaries and employee benefits	2,469	2,273	5,058	4,704
Occupancy expense	1,018	1,034	2,115	1,974
Data processing	26	28	85	59
Professional fees	301	252	790	600
Regulatory assessments	246	225	501	471
Director fees	73	68	143	124
Correspondent bank service charges	19	19	39	38
Loss on California tax credit partnership	37	30	73	60
Net cost on operation of OREO	60	126	177	194
Other	575	627	1,143	1,166
Total noninterest expense	4,824	4,682	10,124	9,390
Income Before Provision for Taxes	3,257	3,392	6,151	5,370
Provision for Taxes on Income	1,236	1,329	2,361	2,079
Net Income	$2,021	$ 2,063	$3,790	$ 3,291
Net Income per common share				
Basic	$0.12	$ 0.13	$0.23	$ 0.20
Diluted	$0.12	$ 0.13	$0.23	$ 0.20
Shares on which net income per common shares were based				
Basic	16,373,996	16,373,996	16,373,996	16,373,996
Diluted	16,378,5[illegible]	16,376,015	16,377,436	16,375,999

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

(In thousands)	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Net Income	$2,021	$2,063	$3,790	$3,291
Unrealized holdings gains (losses) on securities	249	(367)	308	(247)
Unrealized gains on unrecognized post-retirement costs	12	17	24	36
Other comprehensive income (loss), before tax	261	(350)	332	(211)
Tax (expense) benefit related to securities	(99)	147	(123)	99
Tax expense related to unrecognized post-retirement costs	(5)	(7)	(10)	(15)
Total other comprehensive income (loss)	157	(210)	199	(127)
Comprehensive income	$2,178	$1,853	$3,989	$3,164

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

	Common stock				
(In thousands except shares)	Number of Shares	Amount	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance December 31, 2014	15,425,086	$49,271	$33,730	$ (175)	$82,826
Other comprehensive loss				(127)	(127)
Common stock dividends	310,045	1,629	(1,629)		—
Stock-based compensation expense		14			14
Net income			3,291		3,291
Balance June 30, 2015	15,735,131	$50,914	$35,392	$ (302)	$86,004
Other comprehensive income				100	100
Common stock dividends	316,275	1,646	(1,646)		—
Stock-based compensation expense		12			12
Net income			3,519		3,519
Balance December 31, 2015	16,051,406	$52,572	$37,265	$ (202)	$89,635
Other comprehensive income				199	199
Common stock dividends	322,590	1,673	(1,673)		—
Stock-based compensation expense		14			14
Net income			3,790		3,790
Balance June 30, 2016	16,373,996	$54,259	$39,382	$ (3)	$93,638

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

	Six months ended June 30,	
(In thousands)	2016	2015
Cash Flows From Operating Activities:		
Net Income	$3,790	$3,291
Adjustments to reconcile net income:to cash provided by operating activities:		
(Recovery of provision) provision for credit losses	(10)	457
Depreciation and amortization	731	717
Amortization of investment securities	194	139
Accretion of investment securities	(19)	(14)
Increase in accrued interest receivable	(918)	(69)
Decrease in accrued interest payable	(1)	(12)
Decrease in accounts payable and accrued liabilities	(729)	(342)
Increase in unearned fees and unamortized loan origination costs, net	(1,401)	(707)
Decrease in income taxes receivable	1,956	1,997
Stock-based compensation expense	14	14
Benefit for deferred income taxes	194	82
(Gain) loss on sale of other real estate owned	(53)	1
Increase in cash surrender value of bank-owned life insurance	(264)	(258)
Gain on fair value option of financial liabilities	(471)	(199)
Loss on tax credit limited partnership interest	73	60
Net increase in other assets	(77)	(185)
Net cash provided by operating activities	3,009	4,972
Cash Flows From Investing Activities:		
Net increase in interest-bearing deposits with banks	(4)	(3)
Purchase of correspondent bank stock	(101)	(147)
Purchases of available-for-sale securities	(14,940)	—
Maturities of available-for-sale securities	—	2,000
Principal payments of available-for-sale securities	3,330	3,149
Net increase in loans	(38,919)	(45,546)
Cash proceeds from sales of other real estate owned	2,410	41
Payoff of senior liens on other real estate owned	(705)	—
Investment in limited partnership	(66)	(118)
Capital expenditures of premises and equipment	(345)	(360)
Net cash used in investing activities	(49,340)	(40,984)
Cash Flows From Financing Activities:		
Net increase in demand deposits and savings accounts	16,964	18,119
Net decrease in time deposits	(1,820)	(3,531)
Net cash provided by financing activities	15,144	14,588
Net decrease in cash and cash equivalents	(31,187)	(21,424)
Cash and cash equivalents at beginning of period	125,751	103,577
Cash and cash equivalents at end of period	$94,564	$82,153

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

1. Organization and Summary of Significant Accounting and Reporting Policies

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

These unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information on a basis consistent with the accounting policies reflected in the audited financial statements of the Company included in its 2015 Annual Report on Form 10-K. These interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of a normal, recurring nature) considered necessary for a fair presentation have been included. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for any other interim period or for the year as a whole.

Recently Issued Accounting Standards:

In June 2016, FASB issued ASU 2016-13, Financial Instruments- Credit Losses (Topic 326). The FASB is issuing this Update to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The Update requires enhanced disclosures and judgments in estimating credit losses and also amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. This amendment is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. We are currently evaluating the impacts of this ASU on the consolidated financial statements.

In March 2016, FASB issued ASU 2016-09, Compensation-Stock Compensation (Topic 718). The Board is issuing this Update as part of its Simplification Initiative. The objective of the Simplification Initiative is to identify, evaluate, and improve areas of generally accepted accounting principles (GAAP) for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements. The areas for simplification in this Update were identified through outreach for the Simplification Initiative, pre-agenda research for the Private Company Council, and the August 2014 Post-Implementation Review Report on FASB No. 123(R), Share-Based Payment. This ASU is effective for annual reporting periods beginning after December 15, 2016, including interim periods within those annual reporting periods. We are currently evaluating the impacts of this ASU on the consolidated financial statements.

In February 2016, FASB issued ASU 2016-02, Leases (Topic 842). The FASB is issuing this Update to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. To meet that objective, the FASB is amending the FASB Accounting Standards Codification® and creating Topic 842, Leases. This Update, along with IFRS 16, Leases, are the results of the FASB's and the International Accounting Standards Board's (IASB's) efforts to meet that objective and improve financial reporting. This ASU will be effective for public business entities for annual periods beginning after December 15, 2018 (i.e., calendar periods beginning on January 1, 2019), and interim periods therein. We are currently evaluating the impacts of this ASU on the consolidated financial statements.

In January 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-01 Financial Instruments-Overall: Recognition and Measurements of Financial Assets and Financial Liabilities. This ASU requires equity investments to be measured at fair value, with changes in fair value recognized in net

income. The amendment also simplifies the impairment assessment of equity investments for which fair value is not readily determinable by requiring an entity to perform a qualitative assessment to identify impairment. The ASU is effective for fiscal years beginning after December 15, 2017, and interim periods therein. We are currently evaluating the impacts of this ASU on the consolidated financial statements. We are currently evaluating the impacts of this ASU on the consolidated financial statements, however, we believe the accounting and reporting for our mutual fund investments will be impacted.

In September 2015, FASB issued ASU 2015-16, Business Combinations (Topic 805) -Simplifying the Accounting for Measurement-Period Adjustments. GAAP requires that during the amendment period, the acquirer retrospectively adjust the provisional amounts recognized at the acquisition date with a corresponding adjustment to goodwill. Those adjustments are required when new information is obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts initially recognized or would have resulted in the recognition of additional assets or liabilities. To simplify the accounting for adjustments made to provisional amounts recognized in a business

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combination, the amendments in this Update eliminate the requirement to retrospectively account for those adjustments. These amendments in this Update are effective for fiscal years beginning after December 15, 2015. The Company does not expect any impact on the Company's consolidated financial statements resulting from the adoption of the update.

2. Investment Securities

Following is a comparison of the amortized cost and fair value of securities available-for-sale, as of June 30, 2016 and December 31, 2015:

(in 000's) June 30, 2016 Securities available for sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
U.S. Government agencies	$ 13,419	$ 330	$ (4)	$ 13,745
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	24,628	372	—	25,000
Mutual Funds	4,000	—	(110)	3,890
Total securities available for sale	$ 42,047	$ 702	$ (114)	$ 42,635

(in 000's) December 31, 2015 Securities available for sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
U.S. Government agencies	$ 9,778	$ 453	$ (108)	$ 10,123
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	16,835	175	(52)	16,958
Mutual Funds	4,000	—	(188)	3,812
Total securities available for sale	$ 30,613	$ 628	$ (348)	$ 30,893

The amortized cost and fair value of securities available for sale at June 30, 2016, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties. Contractual maturities on collateralized mortgage obligations cannot be anticipated due to allowed paydowns. Mutual funds are included in the "due in one year or less" category below.

(in 000's)	June 30, 2016 Amortized Cost	 Fair Value (Carrying Amount)
Due in one year or less	$4,006	$ 3,896
Due after one year through five years	—	—
Due after five years through ten years	921	938
Due after ten years	12,492	12,801
Collateralized mortgage obligations	24,628	25,000
	$42,047	$ 42,635

There were no realized gains or losses on sales of available-for-sale securities for the three and six month periods ended June 30, 2016 and June 30, 2015. There were no other-than-temporary impairment losses for the three and six month periods ended June 30, 2016 and June 30, 2015.

At June 30, 2016, available-for-sale securities with an amortized cost of approximately $14,266,097 (fair value of $14,784,373) were pledged as collateral for FHLB borrowings and public funds balances.

The Company had no held-to-maturity or trading securities at June 30, 2016 or December 31, 2015.

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Management periodically evaluates each available-for-sale investment security in an unrealized loss position to determine if the impairment is temporary or other-than-temporary.

The following summarizes temporarily impaired investment securities:

(in 000's)	Less than 12 Months		12 Months or More		Total	
June 30, 2016	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses
Securities available for sale:						
U.S. Government agencies	$1,966	$ (4)			$1,966	$ (4)
Mutual Funds	—	—	3,890	(110)	3,890	(110)
Total impaired securities	$1,966	$ (4)	$3,890	$ (110)	$5,856	$ (114)
December 31, 2015						
Securities available for sale:						
U.S. Government agencies	$79	$ (108)	$—	$ —	$79	$ (108)
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	9,913	(52)	—	—	9,913	(52)
Mutual Funds	—	—	3,812	(188)	3,812	(188)
Total impaired securities	$9,992	$ (160)	$3,812	$ (188)	$13,804	$ (348)

Temporarily impaired securities at June 30, 2016, were comprised of one mutual fund and one U.S. government agency security.

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

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

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

Additionally, other-than-temporary-impairment occurs when the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If the Company intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary-impairment shall be recognized in

earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If the Company does not

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

At June 30, 2016, the decline in market value of the impaired mutual fund the one U.S. government agency security is attributable to changes in interest rates, and not credit quality. Because the Company does not have the intent to sell these impaired securities, and it is not more likely than not that it will be required to sell these securities before its anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired at June 30, 2016.

3. Loans

Loans are comprised of the following:

(in 000's)	June 30, 2016	December 31, 2015
Commercial and Business Loans	$57,505	$ 54,503
Government Program Loans	1,977	1,323
Total Commercial and Industrial	59,482	55,826
Real Estate – Mortgage:		
Commercial Real Estate	181,494	182,554
Residential Mortgages	101,300	68,811
Home Improvement and Home Equity loans	760	867
Total Real Estate Mortgage	283,554	252,232
Real Estate Construction and Development	138,174	130,596
Agricultural	46,763	52,137
Installment	29,236	24,527
Total Loans	$557,209	$ 515,318

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

Commercial and industrial loans represent 10.7% of total loans at June 30, 2016 and are generally made to support the ongoing operations of small-to-medium sized commercial businesses. Commercial and industrial loans have a high degree of industry diversification and provide working capital, financing for the purchase of manufacturing plants and equipment, or funding for growth and general expansion of businesses. A substantial portion of commercial and industrial loans are secured by accounts receivable, inventory, leases, or other collateral including real estate. The remainder are unsecured; however, extensions of credit are predicated upon the financial capacity of the borrower. Repayment of commercial loans is generally from the cash flow of the borrower.

Real estate mortgage loans, representing 50.9% of total loans at June 30, 2016, are secured by trust deeds on primarily commercial property, but are also secured by trust deeds on single family residences. Repayment of real estate mortgage loans generally comes from the cash flow of the borrower.

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

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- Residential mortgage loans are provided to individuals to finance or refinance single-family residences. Residential mortgages are not a primary business line offered by the Company, and a majority are conventional mortgages that were purchased as a pool. Most residential mortgages originated by the Company are of a shorter term than conventional mortgages, with maturities ranging from 3 to 15 years on average.

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

Real estate construction and development loans, representing 24.8% of total loans at June 30, 2016, consist of loans for residential and commercial construction projects, as well as land acquisition and development, or land held for future development. Loans in this category are secured by real estate including improved and unimproved land, as well as single-family residential, multi-family residential, and commercial properties in various stages of completion. All real estate loans have established equity requirements. Repayment on construction loans generally comes from long-term mortgages with other lending institutions obtained at completion of the project.

Agricultural loans represent 8.4% of total loans at June 30, 2016 and are generally secured by land, equipment, inventory and receivables. Repayment is from the cash flow of the borrower.

Installment loans represent 5.2% of total loans at June 30, 2016 and generally consist of student loans, loans to individuals for household, family and other personal expenditures such as credit cards, automobiles or other consumer items.

In the normal course of business, the Company is party to financial instruments with off-balance sheet risk to meet the financing needs of its customers. At June 30, 2016 and December 31, 2015, these financial instruments include commitments to extend credit of $112,516,000 and $107,084,000, respectively, and standby letters of credit of $2,717,000 and $3,295,000, respectively. These instruments involve elements of credit risk in excess of the amount recognized on the consolidated balance sheet. The contract amounts of these instruments reflect the extent of the involvement the Company has in off-balance sheet financial instruments.

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

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

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

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Past Due Loans

The Company monitors delinquency and potential problem loans on an ongoing basis through weekly reports to the Loan Committee and monthly reports to the Board of Directors. The following is a summary of delinquent loans at June 30, 2016 (in 000's):

June 30, 2016	Loans 30-60 Days Past Due	Loans 61-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and Business Loans	$ —	$ —	$ —	$ —	$ 57,505	$ 57,505	$ —
Government Program Loans	—	—	—	—	1,977	1,977	—
Total Commercial and Industrial	—	—	—	—	59,482	59,482	—
Commercial Real Estate Loans	—	—	—	—	181,494	181,494	—
Residential Mortgages	—	—	451	451	100,849	101,300	—
Home Improvement and Home Equity Loans	—	—	—	—	760	760	—
Total Real Estate Mortgage	—	—	451	451	283,103	283,554	—
Real Estate Construction and Development Loans	460	—	—	460	137,714	138,174	—
Agricultural Loans	—	—	—	—	46,763	46,763	—
Consumer Loans	—	—	—	—	28,955	28,955	—
Overdraft Protection Lines	—	—	—	—	55	55	—
Overdrafts	—	—	—	—	226	226	—
Total Installment	—	—	—	—	29,236	29,236	—
Total Loans	$ 460	$ —	$ 451	$ 911	$ 556,298	$ 557,209	$ —

The following is a summary of delinquent loans at December 31, 2015 (in 000's):

December 31, 2015	Loans 30-60 Days Past Due	Loans 61-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and Business Loans	$ —	$ —	$ —	$ —	$ 54,503	$ 54,503	$ —
Government Program Loans	13	—	—	13	1,310	1,323	—
Total Commercial and Industrial	13	—	—	13	55,813	55,826	—
Commercial Real Estate Loans	721	—	—	721	181,833	182,554	—
Residential Mortgages	62	392	—	454	68,357	68,811	—
Home Improvement and Home Equity Loans	—	39	—	39	828	867	—
Total Real Estate Mortgage	783	431	—	1,214	251,018	252,232	—
Real Estate Construction and Development Loans	—	706	—	706	129,890	130,596	—
Agricultural Loans	—	—	—	—	52,137	52,137	—
Consumer Loans	—	650	—	650	23,657	24,307	—
Overdraft Protection Lines	—	—	—	—	61	61	—
Overdrafts	—	—	—	—	159	159	—
Total Installment	—	650	—	650	23,877	24,527	—
Total Loans	$ 796	$ 1,787	$ —	$ 2,583	$ 512,735	$ 515,318	$ —

Nonaccrual Loans

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

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

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

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

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

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

All other loans where principal or interest is due and unpaid for 90 days or more are placed on nonaccrual and the accrual of interest for financial statement purposes is discontinued. Previously accrued but unpaid interest is reversed and charged against interest income.

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

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

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

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

Nonaccrual loans totaled $7,562,000 and $8,193,000 at June 30, 2016 and December 31, 2015, respectively. There were no remaining undisbursed commitments to extend credit on nonaccrual loans at June 30, 2016 or December 31, 2015.

The following is a summary of nonaccrual loan balances at June 30, 2016 and December 31, 2015 (in 000's).

	June 30, 2016	December 31, 2015
Commercial and Business Loans	$227	$ —
Government Program Loans	—	328
Total Commercial and Industrial	227	328
Commercial Real Estate Loans	1,178	1,243
Residential Mortgages	451	392
Home Improvement and Home Equity Loans	—	—

Total Real Estate Mortgage	1,629	1,635
Real Estate Construction and Development Loans	4,741	5,580
Agricultural Loans	—	—
Consumer Loans	965	650
Overdraft Protection Lines	—	—
Overdrafts	—	—
Total Installment	965	650
Total Loans	$7,562	$ 8,193

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Impaired Loans

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

The Company applies its normal loan review procedures in making judgments regarding probable losses and loan impairment. The Company evaluates for impairment those loans on nonaccrual status, graded doubtful, graded substandard or those that are troubled debt restructures. The primary basis for inclusion in impaired status under generally accepted accounting pronouncements is that it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement.

A loan is not considered impaired if there is merely an insignificant delay or shortfall in the amounts of payments and the Company expects to collect all amounts due, including interest accrued, at the contractual interest rate for the period of the delay.

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

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

- For loans secured by collateral including real estate and equipment, the fair value of the collateral less selling costs will determine the carrying value of the loan. The difference between the recorded investment in the loan and the fair value, less selling costs, determines the amount of impairment. The Company uses the measurement method based on fair value of collateral when the loan is collateral dependent and foreclosure is probable. For loans that are not considered collateral dependent, a discounted cash flow methodology is used.

- The discounted cash flow method of measuring the impairment of a loan is used for impaired loans that are not considered to be collateral dependent. Under this method, the Company assesses both the amount and timing of cash flows expected from impaired loans. The estimated cash flows are discounted using the loan's effective interest rate. The difference between the amount of the loan on the Bank's books and the discounted cash flow amounts determines the amount of impairment to be provided. This method is used for most of the Company’s troubled debt restructurings or other impaired loans where some payment stream is being collected.

- The observable market price method of measuring the impairment of a loan is only used by the Company when the sale of loans or a loan is in process.

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

Loans other than certain homogeneous loan portfolios are reviewed on a quarterly basis for impairment. Impaired loans are written down to estimated realizable values by the establishment of specific reserves for loan utilizing the discounted cash flow method, or charge-offs for collateral-based impaired loans, or those using observable market pricing.

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The following is a summary of impaired loans at June 30, 2016 (in 000's).

June 30, 2016	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance (1)	Recorded Investment With Allowance (1)	Total Recorded Investment	Related Allowance	Average Recorded Investment (2)	Interest Recognized (2)
Commercial and Business Loans	$ 5,080	$ 630	$ 4,471	$ 5,101	$ 517	$ 5,155	$ 138
Government Program Loans	364	365	—	365	—	367	16
Total Commercial and Industrial	5,444	995	4,471	5,466	517	5,522	154
Commercial Real Estate Loans	1,510	—	1,511	1,511	493	1,438	47
Residential Mortgages	2,953	599	2,362	2,961	193	3,398	66
Home Improvement and Home Equity Loans	—	—	—	—	—	—	—
Total Real Estate Mortgage	4,463	599	3,873	4,472	686	4,836	113
Real Estate Construction and Development Loans	12,100	12,131	—	12,131	596	12,103	374
Agricultural Loans	6	6	—	6	—	11	4
Consumer Loans	965	—	965	965	—	864	35
Overdraft Protection Lines	—	—	—	—	—	—	—
Overdrafts	—	—	—	—	—	—	—
Total Installment	965	—	965	965	—	864	35
Total Impaired Loans	$ 22,978	$ 13,731	$ 9,309	$ 23,040	$ 1,799	$ 23,336	$ 680

(1) The recorded investment in loans includes accrued interest receivable of $62,000.
(2) Information is based on the six month period ended June 30, 2016.

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The following is a summary of impaired loans at December 31, 2015 (in 000's).

December 31, 2015	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance (1)	Recorded Investment With Allowance (1)	Total Recorded Investment	Related Allowance	Average Recorded Investment (2)	Interest Recognized (2)
Commercial and Business Loans	$ 4,855	$ 541	$ 4,333	$ 4,874	$ 530	$ 2,537	$ 302
Government Program Loans	327	327	—	327	—	358	29
Total Commercial and Industrial	5,182	868	4,333	5,201	530	2,895	331
Commercial Real Estate Loans	1,243	—	1,243	1,243	477	1,618	74
Residential Mortgages	4,032	1,051	2,999	4,050	158	4,092	185
Home Improvement and Home Equity Loans	—	—	—	—	—	11	—
Total Real Estate Mortgage	5,275	1,051	4,242	5,293	635	5,721	259
Real Estate Construction and Development Loans	12,489	5,340	7,179	12,519	1,282	7,781	820
Agricultural Loans	16	16	—	16	—	22	9
Consumer Loans	650	—	650	650	650	1,043	21
Overdraft Protection Lines	—	—	—	—	—	—	—
Overdrafts	—	—	—	—	—	—	—
Total Installment	650	—	650	650	650	1,043	21
Total Impaired Loans	$ 23,612	$ 7,275	$ 16,404	$ 23,679	$ 3,097	$ 17,462	$ 1,440

(1) The recorded investment in loans includes accrued interest receivable of $67,000.
(2) Information is based on the twelve month period ended December 31, 2015.

In most cases, the Company uses the cash basis method of income recognition for impaired loans. In the case of certain troubled debt restructurings for which the loan is performing under the current contractual terms for a reasonable period of time, income is recognized under the accrual method.

The average recorded investment in impaired loans for the quarters ended June 30, 2016 and 2015 was $23,163,000 and $15,867,000, respectively. Interest income recognized on impaired loans for the quarters ended June 30, 2016 and 2015 was approximately $317,000 and $144,000, respectively. For impaired nonaccrual loans, interest income recognized under a cash-basis method of accounting was approximately $87,000 and $41,000 for the quarters ended June 30, 2016 and 2015, respectively.

The average recorded investment in impaired loans for the six months ended June 30, 2016 and 2015 was $23,336,000 and $15,923,000, respectively. Interest income recognized on impaired loans for the six months ended June 30, 2016 and 2015 was approximately $680,000 and $391,000, respectively. For impaired nonaccrual loans, interest income recognized under a cash-basis method of accounting was approximately $236,000 and $200,000 for the six months ended June 30, 2016 and 2015, respectively.

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Troubled Debt Restructurings

In certain circumstances, when the Company grants a concession to a borrower as part of a loan restructuring, the restructuring is accounted for as a troubled debt restructuring (TDR). TDRs are reported as a component of impaired loans.

A TDR is a type of restructuring in which the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession (either imposed by court order, law, or agreement between the borrower and the Bank) to the borrower that it would not otherwise consider. Although the restructuring may take different forms, the Company's objective is to maximize recovery of its investment by granting relief to the borrower.

A TDR may include, but is not limited to, one or more of the following:

- A transfer from the borrower to the Company of receivables from third parties, real estate, other assets, or an equity interest in the borrower is granted to fully or partially satisfy the loan.

- A modification of terms of a debt such as one or a combination of:

The reduction (absolute or contingent) of the stated interest rate.
The extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk.
The reduction (absolute or contingent) of the face amount or maturity amount of debt as stated in the instrument or agreement.
The reduction (absolute or contingent) of accrued interest.
For a restructured loan to return to accrual status there needs to be, among other factors, at least 6 months successful payment history. In addition, the Company performs a financial analysis of the credit to determine whether the borrower has the ability to continue to meet payments over the remaining life of the loan. This includes, but is not limited to, a review of financial statements and cash flow analysis of the borrower. Only after determination that the borrower has the ability to perform under the terms of the loans, will the restructured credit be considered for accrual status. Although the Company does not have a policy which specifically addresses when a loan may be removed from TDR classification, as a matter of practice, loans classified as TDRs generally remain classified as such until the loan either reaches maturity or its outstanding balance is paid off.

The following tables illustrates TDR activity for the periods indicated:

($ in 000's)	Three Months Ended June 30, 2016				
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts which Defaulted During Period	Recorded Investment on Defaulted TDRs
Troubled Debt Restructurings					
Commercial and Business Loans	1	$ 395	$ 227	—	$ —
Government Program Loans	—	—	—	—	—
Commercial Real Estate Term Loans	—	—	—	—	—
Single Family Residential Loans	—	—	—	—	—
Home Improvement and Home Equity Loans	—	—	—	—	—

Real Estate Construction and Development Loans	—	—	—	—	
Agricultural Loans	—	—	—	—	
Consumer Loans	—	—	—	—	
Overdraft Protection Lines	—	—	—	—	
Total Loans	1 $ 395	$ 227	—	$	—

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($ in 000's)	Six Months Ended June 30, 2016 Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts which Defaulted During Period	Recorded Investment on Defaulted TDRs
Troubled Debt Restructurings					
Commercial and Business Loans	4	$ 1,021	$ 749	—	$ —
Government Program Loans	1	100	100	—	—
Commercial Real Estate Term Loans	—	—	—	—	—
Single Family Residential Loans	—	—	—	—	—
Home Improvement and Home Equity Loans	—	—	—	—	—
Real Estate Construction and Development Loans	—	—	—	—	—
Agricultural Loans	—	—	—	—	—
Consumer Loans	—	—	—	—	—
Overdraft Protection Lines	—	—	—	—	—
Total Loans	5	$ 1,121	$ 849	—	$ —

($ in 000's)	Three Months Ended June 30, 2015 Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts which Defaulted During Period	Recorded Investment on Defaulted TDRs
Troubled Debt Restructurings					
Commercial and Business Loans	—	$ —	$ —	—	$ —
Government Program Loans	—	—	—	—	—
Commercial Real Estate Term Loans	—	—	—	—	—
Single Family Residential Loans	—	—	—	—	—
Home Improvement and Home Equity Loans	—	—	—	—	—
Real Estate Construction and Development Loans	—	—	—	—	—
Agricultural Loans	—	—	—	—	—
Consumer Loans	—	—	—	—	—
Overdraft Protection Lines	—	—	—	—	—
Total Loans	—	$ —	$ —	—	$ —

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($ in 000's)	Six Months Ended June 30, 2015 Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts which Defaulted During Period	Recorded Investment on Defaulted TDRs
Troubled Debt Restructurings					
Commercial and Business Loans	1	$ 258	$ 254	—	$ —
Government Program Loans	—	—	—	—	—
Commercial Real Estate Term Loans	—	—	—	—	—
Single Family Residential Loans	—	—	—	—	—
Home Improvement and Home Equity Loans	—	—	—	—	—
Real Estate Construction and Development Loans	—	—	—	—	—
Agricultural Loans	—	—	—	—	—
Consumer Loans	—	—	—	—	—
Overdraft Protection Lines	—	—	—	—	—
Total Loans	1	$ 258	$ 254	—	$ —

The Company makes various types of concessions when structuring TDRs including rate reductions, payment extensions, and forbearance. At June 30, 2016, the Company had 29 restructured loans totaling $18,217,000 as compared to 29 restructured loans totaling $18,508,000 at December 31, 2015.

The following tables summarize TDR activity by loan category for the six months ended June 30, 2016 and June 30, 2015 (in 000's).

Six Months Ended June 30, 2016	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Improvement and Home Equity	Real Estate Construction Development	Agricultural	Installment & Other	Total
Beginning balance	$ 898	$ 1,243	$ 3,533	$ —	$ 12,168	$ 16	$ 650	$ 18,508
Defaults	—	—	—	—	—	—	—	—
Additions	849	—	—	—	—	—	—	849
Principal additions (reductions)	(511)	267	(1,133)	—	(68)	(10)	315	(1,140)
Ending balance	$ 1,236	$ 1,510	$ 2,400	$ —	$ 12,100	$ 6	$ 965	$ 18,217
Allowance for loan loss	$ 43	$ 493	$ 186	$ —	$ —	$ —	$ 596	$ 1,318

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Six Months Ended June 30, 2015	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Improvement and Home Equity	Real Estate Construction Development	Agricultural	Installment & Other	Total
Beginning balance	$ 1,306	$ 2,713	$ 4,225	$ —	$ 6,029	$ 32	$ 695	$ 15,000
Defaults	—	—	—	—	—	—	—	—
Additions	—	—	254	—	—	—	—	254
Principal reductions	(331)	(1,411)	(841)	—	(159)	(7)	(46)	(2,795)
Ending balance	$ 975	$ 1,302	$ 3,638	$ —	$ 5,870	$ 25	$ 649	$ 12,459
Allowance for loan loss	$ 18	$ 441	$ 150	$ —	$ 80	$ —	$ 132	$ 821

The following tables summarize TDR activity by loan category for the quarters ended June 30, 2016 and June 30, 2015.

Three months ended June 30, 2016	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Improvement and Home Equity	Real Estate Construction Development	Agricultural	Installment & Other	Total
Beginning balance	$ 1,735	$ 1,557	$ 2,680	$ —	$ 11,632	$ 10	$ 977	$ 18,591
Defaults	—	—	—	—	—	—	—	—
Additions	227	—	—	—	—	—	—	227
Principal (reductions) additions	(726)	(47)	(280)	—	468	(4)	(12)	(601)
Ending balance	$ 1,236	$ 1,510	$ 2,400	$ —	$ 12,100	$ 6	$ 965	$ 18,217
Allowance for loan loss	$ 43	$ 493	$ 186	$ 0	$ —	$ —	$ 596	$ 1,318

Three months ended June 30, 2015	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Improvement and Home Equity	Real Estate Construction Development	Agricultural	Installment & Other	Total
Beginning balance	$ 1,203	$ 2,646	$ 4,282	$ —	$ 5,950	$ 28	$ 694	$ 14,803
Defaults	—	—	—	—	—	—	—	—
Additions	—	—	—	—	—	—	—	—
Principal reductions	(228)	(1,344)	(644)	—	(80)	(3)	(45)	(2,344)
Ending balance	$ 975	$ 1,302	$ 3,638	$ —	$ 5,870	$ 25	$ 649	$ 12,459
Allowance for loan loss	$ 18	$ 441	$ 150	$ —	$ 80	$ —	$ 132	$ 821

Credit Quality Indicators

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

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

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

Facility Rating:

The facility rating is determined by the analysis of positive and negative factors that may indicate that the quality of a particular loan or credit arrangement requires that it be rated differently from the risk rating assigned to the borrower. The Company assesses the risk impact of these factors:

Collateral - The rating may be affected by the type and quality of the collateral, the degree of coverage, the economic life of the collateral, liquidation value and the Company's ability to dispose of the collateral.

Guarantees - The value of third party support arrangements varies widely. Unconditional guaranties from persons with demonstrable ability to perform are more substantial than that of closely related persons to the borrower who offer only modest support.

Unusual Terms - Credit may be extended on terms that subject the Company to a higher level of risk than indicated in the rating of the borrower.

Borrower Rating:

The borrower rating is a measure of loss possibility based on the historical, current and anticipated financial characteristics of the borrower in the current risk environment. To determine the rating, the Company considers at least the following factors:

- Quality of management
- Liquidity
- Leverage/capitalization
- Profit margins/earnings trend
- Adequacy of financial records
- Alternative funding sources
- Geographic risk
- Industry risk
- Cash flow risk
- Accounting practices
- Asset protection
- Extraordinary risks

The Company assigns risk ratings to loans other than consumer loans and other homogeneous loan pools based on the following scale. The risk ratings are used when determining borrower ratings as well as facility ratings. When the borrower rating and the facility ratings differ, the lowest rating applied is:

- Grades 1 and 2 – These grades include loans which are given to high quality borrowers with high credit quality and sound financial strength. Key financial ratios are generally above industry averages and the borrower's strong earnings history or net worth. These may be secured by deposit accounts or high-grade investment securities.

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

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based borrowers assigned this rating must exhibit extremely favorable leverage and cash flow characteristics, and consistently demonstrate a high level of unused borrowing capacity.

- Grades 4 and 5 – These include "pass" grade loans to borrowers of acceptable credit quality and risk. The borrower's balance sheet and financial ratios may be below industry averages, but above the lowest industry quartile. Leverage is above and liquidity is below industry averages. Inadequacies evident in financial performance and/or management sufficiency are offset by readily available features of support, such as adequate collateral, or good guarantors having the liquid assets and/or cash flow capacity to repay the debt. The borrower may have recognized a loss over three or four years, however recent earnings trends, while perhaps somewhat cyclical, are improving and cash flows are adequate to cover debt service and fixed obligations. Real estate and asset-borrowers fully comply with all underwriting standards and are performing according to projections would be assigned this rating. These also include grade 5 loans which are "leveraged" or on management's "watch list." While still considered pass loans (loans given a grade 5), the borrower's financial condition, cash flow or operations evidence more than average risk and short term weaknesses, these loans warrant a higher than average level of monitoring, supervision and attention from the Company, but do not reflect credit weakness trends that weaken or inadequately protect the Company's credit position. Loans with a grade rating of 5 are not normally acceptable as new credits unless they are adequately secured or carry substantial endorser/guarantors.

- Grade 6 – This grade includes "special mention" loans which are loans that are currently protected but are potentially weak. This generally is an interim grade classification and should usually be upgraded to an Acceptable rating or downgraded to Substandard within a reasonable time period. Weaknesses in special mention loans may, if not checked or corrected, weaken the asset or inadequately protect the Company's credit position at some future date. Special mention loans are often loans with weaknesses inherent from the loan origination, loan servicing, and perhaps some technical deficiencies. The main theme in special mention credits is the distinct probability that the classification will deteriorate to a more adverse class if the noted deficiencies are not addressed by the loan officer or loan management.

- Grade 7 – This grade includes "substandard" loans which are inadequately supported by the current sound net worth and paying capacity of the borrower or of the collateral pledged, if any. Substandard loans have a well-defined weakness or weaknesses that may impair the regular liquidation of the debt. Substandard loans exhibit a distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Substandard loans also include impaired loans.

- Grade 8 – This grade includes "doubtful" loans which exhibit the same characteristics as the Substandard loans with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include a proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans.

- Grade 9 – This grade includes loans classified "loss" which are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off the asset even though partial recovery may be achieved in the future.

The Company did not carry any loans graded as loss at June 30, 2016 or December 31, 2015.

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The following tables summarize the credit risk ratings for commercial, construction, and other non-consumer related loans for June 30, 2016 and December 31, 2015:

June 30, 2016 (in 000's)	Commercial and Industrial	Commercial Real Estate	Real Estate Construction and Development	Agricultural	Total
Grades 1 and 2	$ 338	$ —	$ —	$ 20	$358
Grade 3	7,007	5,885	—	—	12,892
Grades 4 and 5 – pass	46,295	173,803	117,561	46,743	384,402
Grade 6 – special mention	1,339	628	911	—	2,878
Grade 7 – substandard	4,504	1,178	19,701	—	25,383
Grade 8 – doubtful	—	—	—	—	—
Total	$ 59,483	$ 181,494	$ 138,173	$ 46,763	$425,913

December 31, 2015 (in 000's)	Commercial and Industrial	Commercial Real Estate	Real Estate Construction and Development	Agricultural	Total
Grades 1 and 2	$ 519	$ —	$ —	$ 50	$569
Grade 3	5,008	5,964	—	—	10,972
Grades 4 and 5 – pass	44,341	173,731	103,607	52,087	373,766
Grade 6 – special mention	946	1,616	—	—	2,562
Grade 7 – substandard	5,012	1,243	26,989	—	33,244
Grade 8 – doubtful	—	—	—	—	—
Total	$ 55,826	$ 182,554	$ 130,596	$ 52,137	$421,113

The Company follows consistent underwriting standards outlined in its loan policy for consumer and other homogeneous loans but, does not specifically assign a risk rating when these loans are originated. Consumer loans are monitored for credit risk and are considered “pass” loans until some issue or event requires that the credit be downgraded to special mention or worse.

The following tables summarize the credit risk ratings for consumer related loans and other homogeneous loans for June 30, 2016 and December 31, 2015:

	June 30, 2016				December 31, 2015			
(in 000's)	Residential Mortgages	Home Improvement and Home Equity	Installment	Total	Residential Mortgages	Home Improvement and Home Equity	Installment	Total
Not graded	$81,622	$ 733	$ 26,421	$108,776	$47,135	$ 839	$ 23,213	$71,187
Pass	17,436	27	1,850	19,313	19,466	28	664	20,158
Special Mention	—	—	—	—	—	—	—	—
Substandard	2,242	—	—	2,242	2,210	—	650	2,860
Doubtful	—	—	965	965	—	—	—	—
Total	$101,300	$ 760	$ 29,236	$131,296	$68,811	$ 867	$ 24,527	$94,205

Allowance for Loan Losses

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

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

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

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

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

Home improvement and home equity loans – Because of their junior lien position, these loans have an inherently higher risk level. Because residential real estate has been severely distressed in the recent past, the anticipated risk for this loan segment has increased.

Real estate construction and development loans –In a normal economy, this segment of loans is considered to have a higher risk profile due to construction and market value issues in conjunction with normal credit risks. Although residential real estate markets have improved, they are still distressed on a historical basis, and therefore carry higher risk.

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

Installment loans (Includes consumer loans, overdrafts, and overdraft protection lines) – This segment is higher risk because many of the loans are unsecured.

The following summarizes the activity in the allowance for credit losses by loan category for the six months ended June 30, 2016 and 2015 (in 000's).

Six Months Ended June 30, 2016	Commercial and Industrial	Real Estate Mortgage	Real Estate Construction Development	Agricultural	Installment & Other	Unallocated	Total
Beginning balance	$ 1,652	$ 1,449	$ 4,629	$ 655	$ 1,258	$ 70	$ 9,713
Provision (recovery of provision) for credit losses	837	225	(1,204)	(101)	(44)	277	(10)
Charge-offs	(842)	(22)	—	—	—	(16)	(880)
Recoveries	38	13	30	—	5	—	86
Net recoveries	(804)	(9)	30	—	5	(16)	(794)
Ending balance	$ 1,685	$ 1,665	$ 3,455	$ 554	$ 1,219	$ 331	$ 8,909
Period-end amount allocated to:							
Loans individually evaluated for impairment	497	686	—	—	596	—	1,779
	1,188	979	3,455	554	623	331	7,130

Loans collectively evaluated for impairment							
Ending balance	$ 1,685	$ 1,665	$ 3,455	$ 554	$ 1,219	$ 331	$ 8,909

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Six Months Ended June 30, 2015	Commercial and Industrial	Real Estate Mortgage	Real Estate Construction Development	Agricultural	Installment & Other	Unallocated	Total
Beginning balance	$ 1,219	$ 1,653	$ 6,278	$ 481	$ 293	$ 847	$ 10,771
Provision (recovery of provision) for credit losses	812	(170)	52	(31)	535	(741)	457
Charge-offs	(385)	—	—	—	(17)	(6)	(408)
Recoveries	571	126	30	—	4	1	732
Net charge-offs	186	126	30	—	(13)	(5)	324
Ending balance	$ 2,217	$ 1,609	$ 6,360	$ 450	$ 815	$ 101	$ 11,552
Period-end amount allocated to:							
Loans individually evaluated for impairment	1,002	591	146	—	583	—	2,322
Loans collectively evaluated for impairment	1,215	1,018	6,214	450	232	101	9,230
Ending balance	$ 2,217	$ 1,609	$ 6,360	$ 450	$ 815	$ 101	$ 11,552

The following summarizes the activity in the allowance for credit losses by loan category for the quarters ended June 30, 2016 and 2015 (in 000's).

Three Months Ended June 30, 2016	Commercial and Industrial	Real Estate Mortgage	Real Estate Construction Development	Agricultural	Installment & Other	Unallocated	Total
Beginning balance	$ 2,313	$ 1,459	$ 3,273	$ 545	$ 1,237	$ 892	$ 9,719
Recovery of provision for credit losses	193	200	182	9	(20)	(552)	12
Charge-offs	(839)	—	—	—	—	(9)	(848)
Recoveries	18	6	—	—	2	—	26
Net charge-offs	(821)	6	—	—	2	(9)	(822)
Ending balance	$ 1,685	$ 1,665	$ 3,455	$ 554	$ 1,219	$ 331	$ 8,909
Period-end amount allocated to:							
Loans individually evaluated for impairment	497	686	—	—	596	—	1,779
Loans collectively evaluated for impairment	1,188	979	3,455	554	623	331	7,130
Ending balance	$ 1,685	$ 1,665	$ 3,455	$ 554	$ 1,219	$ 331	$ 8,909

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Three Months Ended June 30, 2015	Commercial and Industrial	Real Estate Mortgage	Real Estate Construction Development	Agricultural	Installment & Other	Unallocated	Total
Beginning balance	$ 2,075	$ 1,744	$ 6,209	$ 493	$ 761	$ 8	$ 11,290
Provision for credit losses	(22)	(254)	151	(43)	69	97	(2)
Charge-offs	(170)	—	—	—	(17)	(4)	(191)
Recoveries	334	119	—	—	2	—	455
Net charge-offs	164	119	0	0	(15)	(4)	264
Ending balance	$ 2,217	$ 1,609	$ 6,360	$ 450	$ 815	$ 101	$ 11,552
Period-end amount allocated to:							
Loans individually evaluated for impairment	1,002	591	146	—	583	—	2,322
Loans collectively evaluated for impairment	1,215	1,018	6,214	450	232	101	9,230
Ending balance	$ 2,217	$ 1,609	$ 6,360	$ 450	$ 815	$ 101	$ 11,552

The following summarizes information with respect to the loan balances at June 30, 2016 and 2015.

	June 30, 2016			June 30, 2015		
(in 000's)	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Total Loans	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Total Loans
Commercial and Business Loans	$ 5,101	$ 52,404	$ 57,505	$ 1,669	$ 57,927	$ 59,596
Government Program Loans	365	1,612	1,977	368	1,414	1,782
Total Commercial and Industrial	5,466	54,016	59,482	2,037	59,341	61,378
Commercial Real Estate Loans	1,511	179,983	181,494	1,302	162,165	163,467
Residential Mortgage Loans	2,961	98,339	101,300	3,915	71,930	75,845
Home Improvement and Home Equity Loans	—	760	760	—	994	994
Total Real Estate Mortgage	4,472	279,082	283,554	5,217	235,089	240,306
Real Estate Construction and Development Loans	12,131	126,043	138,174	6,200	151,327	157,527
Agricultural Loans	6	46,757	46,763	25	33,795	33,820
Installment Loans	965	28,271	29,236	1,103	9,613	10,716
Total Loans	$ 23,040	$ 534,169	$ 557,209	$ 14,582	$ 489,165	$ 503,747

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4. Deposits

Deposits include the following:

(in 000's)	June 30, 2016	December 31, 2015
Noninterest-bearing deposits	$272,058	$ 262,168
Interest-bearing deposits:		
NOW and money market accounts	232,583	226,886
Savings accounts	64,969	63,592
Time deposits:		
Under $250,000	55,919	58,122
$250,000 and over	11,420	11,037
Total interest-bearing deposits	364,891	359,637
Total deposits	$636,949	$ 621,805
Total brokered deposits included in time deposits above	$7,359	$ 8,546

5. Short-term Borrowings/Other Borrowings

At June 30, 2016, the Company had collateralized lines of credit with the Federal Reserve Bank of San Francisco totaling $297,519,000, as well as Federal Home Loan Bank (FHLB) lines of credit totaling $2,443,000. At June 30, 2016, the Company had an uncollateralized line of credit with Pacific Coast Bankers Bank ("PCBB") totaling $10,000,000 and a Fed Funds line of $20,000,000 with Zions First National Bank. All lines of credit are on an “as available” basis and can be revoked by the grantor at any time. These lines of credit have interest rates that are generally tied to the Federal Funds rate or are indexed to short-term U.S. Treasury rates or LIBOR. FHLB advances are collateralized by the Company’s stock in the FHLB, investment securities, and certain qualifying mortgage loans. As of June 30, 2016, $2,583,000 in investment securities at FHLB were pledged as collateral for FHLB advances. Additionally, $427,940,000 in secured and unsecured loans were pledged at June 30, 2016, as collateral for borrowing lines with the Federal Reserve Bank totaling $297,519,000. At June 30, 2016, the Company had no outstanding borrowings.

At December 31, 2015, the Company had collateralized lines of credit with the Federal Reserve Bank of San Francisco totaling $302,456,000, as well as Federal Home Loan Bank (“FHLB”) lines of credit totaling $2,854,000. At December 31, 2015, the Company had an uncollateralized line of credit with Pacific Coast Bankers Bank ("PCBB") totaling $10,000,000. These lines of credit generally have interest rates tied to the Federal Funds rate or are indexed to short-term U.S. Treasury rates or LIBOR. FHLB advances are collateralized by the Company’s stock in the FHLB, investment securities, and certain qualifying mortgage loans. As of December 31, 2015, $3,023,000 in investment securities at FHLB were pledged as collateral for FHLB advances. Additionally, $444,596,000 in secured and unsecured loans were pledged at December 31, 2015, as collateral for used and unused borrowing lines with the Federal Reserve Bank totaling $302,456,000. All lines of credit are on an “as available” basis and can be revoked by the grantor at any time. At December 31, 2015, the Company had no outstanding borrowings.

6. Supplemental Cash Flow Disclosures

(in 000's)	Six months ended June 30, 2016	2015

Cash paid during the period for:		
Interest	$666	$641
Income taxes	$210	$—
Noncash investing activities:		
Loans transferred to foreclosed assets	$—	$42
OREO financed		