AMERICAN RIVER BANKSHARES
Form 10-Q
November 03, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

or

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

For the transition period from to

Commission File Number: 0-31525

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

charter)

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

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

(916) 851-0123
(Registrant's telephone number, including area code)

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

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

Yes x No o

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

Yes x No o

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

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

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

Yes 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:

No par value Common Stock - 6,656,594 shares outstanding at November 2, 2016.

AMERICAN RIVER BANKSHARES

INDEX TO QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2016

101.SCH XBRL Taxonomy Extension Schema
101.CAL XBRL Taxonomy Extension Calculation
101.DEF XBRL Taxonomy Extension Definition
101.LAB XBRL Taxonomy Extension Label
101.PRE XBRL Taxonomy Extension Presentation

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PART I-FINANCIAL INFORMATION

Item 1. Financial Statements.

AMERICAN RIVER BANKSHARES

CONSOLIDATED BALANCE SHEET

(Unaudited)

(dollars in thousands)	September 30, 2016	December 31, 2015
ASSETS		
Cash and due from banks	$ 43,094	$ 23,727
Interest-bearing deposits in banks	999	750
Investment securities:		
Available-for-sale, at fair value	253,502	273,819
Held-to-maturity, at amortized cost	508	623
Loans and leases, less allowance for loan and lease losses of $4,983 at September 30, 2016 and $4,975 at December 31, 2015	313,302	289,102
Premises and equipment, net	1,259	1,407
Federal Home Loan Bank stock	3,779	3,779
Goodwill and other intangible assets	16,321	16,321
Other real estate owned	653	3,551
Bank owned life insurance	14,722	14,483
Accrued interest receivable and other assets	5,707	7,078
	$ 653,846	$ 634,640
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest bearing	$ 209,586	$ 190,548
Interest-bearing	336,579	340,142
Total deposits	546,165	530,690
Short-term borrowings	5,000	3,500
Long-term borrowings	9,000	7,500
Accrued interest payable and other liabilities	9,015	6,875
Total liabilities	569,180	548,565
Shareholders' equity:		
Preferred stock, no par value; 20,000,000 shares authorized; none outstanding		
Common stock, no par value; 20,000,000 shares authorized; issued and outstanding – 6,656,594 shares at September 30, 2016 and 7,343,649 shares at December 31, 2015	42,402	49,554

Retained earnings	38,907	34,418
Accumulated other comprehensive income, net of taxes	3,357	2,103
Total shareholders' equity	84,666	86,075
	$ 653,846	$ 634,640

See Notes to Unaudited Consolidated Financial Statements

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AMERICAN RIVER BANKSHARES

CONSOLIDATED STATEMENT OF INCOME

(Unaudited)

(dollars in thousands, except per share data)				
For the periods ended September 30,	Three months		Nine months	
	2016	2015	2016	2015
Interest income:				
Interest and fees on loans:				
Taxable	$3,617	$3,541	$10,424	$10,140
Exempt from Federal income taxes	189	92	534	222
Interest on deposits in banks	2	2	5	4
Interest and dividends on investment securities:				
Taxable	1,340	1,633	4,333	4,706
Exempt from Federal income taxes	156	190	502	571
Dividends	—	—	11	10
Total interest income	5,304	5,458	15,809	15,643
Interest expense:				
Interest on deposits	179	202	545	624
Interest on borrowings	44	38	133	108
Total interest expense	223	240	678	732
Net interest income	5,081	5,218	15,131	14,911
Provision for loan and lease losses	(668)	—	(668)	—
Net interest income after provision for loan and lease losses	5,749	5,218	15,799	14,911
Noninterest income:				
Service charges on deposit accounts	124	132	381	376
Gain on sale, call, or impairment of securities	33	33	314	251
Rental income from other real estate owned	—	87	106	248
Other noninterest income	242	238	715	707
Total noninterest income	399	490	1,516	1,582
Noninterest expense:				
Salaries and employee benefits	2,073	2,185	6,334	6,500
Occupancy	295	294	885	888
Furniture and equipment	165	171	493	527
Federal Deposit Insurance Corporation assessments	77	83	233	239
Expenses related to other real estate owned	(30)	58	330	260
Other expense	766	641	2,277	2,246
Total noninterest expense	3,346	3,432	10,552	10,660
Income before provision for income taxes	2,802	2,276	6,763	5,833
Provision for income taxes	989	807	2,274	2,022

Net income	$1,813	$1,469	$4,489	$3,811
Basic earnings per share	$0.28	$0.20	$0.66	$0.50
Diluted earnings per share	$0.27	$0.20	$0.66	$0.50
Cash dividends per share	$0.00	$0.00	$0.00	$0.00

See notes to Unaudited Consolidated Financial Statements

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AMERICAN RIVER BANKSHARES

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(Unaudited)

(dollars in thousands, except per share data)				
For the periods ended September 30,	Three months		Nine months	
	2016	2015	2016	2015
Net income	$1,813	$1,469	$4,489	$3,811
Other comprehensive income (loss):				
(Decrease) increase in net unrealized gains on investment securities	(1,306)	769	2,406	1,023
Deferred tax benefit (expense)	522	(308)	(963)	(409)
(Decrease) increase in net unrealized gains on investment securities, net of tax	(784)	461	1,443	614
Reclassification adjustment for realized gains included in net income	(33)	(33)	(314)	(251)
Tax effect	13	13	125	100
Realized gains, net of tax	(20)	(20)	(189)	(151)
Total other comprehensive (loss) income	(804)	441	1,254	463
Comprehensive income	$1,009	$1,910	$5,743	$4,274

See Notes to Unaudited Consolidated Financial Statements

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AMERICAN RIVER BANKSHARES

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(Unaudited)

(dollars in thousands)	Common Stock			Accumulated Other	Total
			Retained	Comprehensive	Shareholders'
	Shares	Amount	Earnings	Income	Equity
Balance, January 1, 2015	8,089,615	$57,126	$29,150	$ 3,371	$ 89,647
Net income			3,811		3,811
Other comprehensive income, net of tax:					
Net change in unrealized gains on available-for-sale investment securities				463	463
Net restricted stock award activity and related compensation expense	45,023	175			175
Stock option compensation expense		25			25
Retirement of common stock	(790,989)	(7,843)			(7,843)
Balance, September 30, 2015	7,343,649	$49,483	$32,961	$ 3,834	$ 86,278
Balance, January 1, 2016	7,343,649	$49,554	$34,418	$ 2,103	$ 86,075
Net income			4,489		4,489
Other comprehensive income, net of tax:					
Net change in unrealized gains on available-for-sale investment securities				1,254	1,254
Net restricted stock award activity and related compensation expense	28,342	219			219
Stocks option exercised and compensation expense	1,500	43			43
Retirement of common stock	(716,897)	(7,414)			(7,414)
Balance, September 30, 2016	6,656,594	$42,402	$38,907	$ 3,357	$ 84,666

See Notes to Unaudited Consolidated Financial Statements

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AMERICAN RIVER BANKSHARES

CONSOLIDATED STATEMENT OF CASH FLOWS
(Unaudited)

(dollars in thousands) For the nine months ended September 30,	2016	2015
Cash flows from operating activities:		
Net income	$4,489	$3,811
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	(668)	—
Increase (decrease) in deferred loan origination fees, net	27	(48)
Depreciation and amortization	326	324
Gain on sale, call, and impairment of investment securities, net	(314)	(251)
Amortization of investment security premiums and discounts, net	2,159	2,470
Increase in cash surrender values of life insurance policies	(239)	(239)
Stock based compensation expense	249	200
Loss/gain on sale/write-down of other real estate owned	207	68
Decrease in accrued interest receivable and other assets	535	27
(Decrease) increase in accrued interest payable and other liabilities	(322)	133
Net cash provided by operating activities	6,449	6,495
Cash flows from investing activities:		
Proceeds from the sale of available-for-sale investment securities	12,656	23,764
Proceeds from matured available-for-sale investment securities	600	175
Proceeds from called available-for-sale investment securities	1,165	—
Purchases of available-for-sale investment securities	(25,146)	(41,254)
Proceeds from principal repayments for available-for-sale investment securities	33,749	38,193
Proceeds from principal repayments for held-to-maturity investment securities	115	188
Net increase in interest-bearing deposits in banks	(249)	—
Net increase in loans	(21,873)	(31,669)
Proceeds from sale of other real estate	1,005	924
Capitalized additions to other real estate	—	(126)
Net increase in FHLB stock	—	(93)
Purchases of equipment	(178)	(241)
Net cash provided by (used in) investing activities	1,844	(10,139)
Cash flows from financing activities:		
Net increase in demand, interest-bearing and savings deposits	$17,125	$12,200
Net decrease in time deposits	(1,650)	(1,524)
Net increase in short-term borrowings	1,500	—
Net increase in long-term borrowings	1,500	—
Proceeds from stock option exercise	13	—
Cash paid to repurchase common stock	(7,414)	(7,843)

Net cash provided by financing activities	$11,074	$2,833
Increase (decrease) in cash and cash equivalents	19,367	(811)
Cash and cash equivalents at beginning of year	23,727	22,449
Cash and cash equivalents at end of period	$43,094	$21,638

See Notes to Unaudited Consolidated Financial Statements

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AMERICAN RIVER BANKSHARES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2016

1. CONSOLIDATED FINANCIAL STATEMENTS

In the opinion of management, the unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the consolidated financial position of American River Bankshares (the "Company:") at September 30, 2016 and December 31, 2015, the results of its operations and statement of comprehensive income for the three-month and nine-month periods ended September 30, 2016 and 2015, its cash flows for the nine-month periods ended September 30, 2016 and 2015 and its statement of changes in shareholders' equity for the nine months ended September 30, 2016 and 2015 in conformity with accounting principles generally accepted in the United States of America.

Certain disclosures normally presented in the notes to the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The Company believes that the disclosures are adequate to make the information not misleading. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2015. The results of operations for the three-month and nine-month periods ended September 30, 2016 may not necessarily be indicative of the operating results for the full year.

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

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

2. STOCK-BASED COMPENSATION

Equity Plans

On March 17, 2010, the Board of Directors adopted the 2010 Equity Incentive Plan (the “2010 Plan”). The 2010 Plan was approved by the Company’s shareholders on May 20, 2010. In 2000, the Board of Directors adopted and the Company’s shareholders approved a stock option plan (the “2000 Plan”), under which 110,587 options remain outstanding at September 30, 2016. At September 30, 2016, under the 2010 Plan, there were 76,461 stock options and 66,692 restricted shares outstanding and the total number of authorized shares that remain available for issuance was 1,376,819. The 2010 Plan provides for the following types of stock-based awards: incentive stock options; nonqualified stock options; stock appreciation rights; restricted stock; restricted performance stock; unrestricted Company stock; and performance units. Awards under the 2000 Plan were either incentive stock options or nonqualified stock options. Under the 2010 Plan, the awards may be granted to employees and directors under incentive and nonqualified option agreements, restricted stock agreements, and other awards agreements. The 2010 Plan and the 2000 Plan (collectively the “Plans”) require that the option price may not be less than the fair market value of the stock at the date the option is awarded. The option awards under the Plans expire on dates determined by the Board of Directors, but not later than ten years from the date of award. The vesting period is generally five years; however, the vesting period can be modified at the discretion of the Company’s Board of Directors. Outstanding option awards under the Plans are exercisable until their expiration, however, no new options will be awarded under the 2000 Plan. New shares are issued upon exercise of an option.

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

Equity Compensation

For the three-month periods ended September 30, 2016 and 2015, the compensation cost recognized for equity compensation was $83,000 and $73,000, respectively. The recognized tax benefit for equity compensation expense was $29,000 and $25,000, respectively, for the three-month periods ended September 30, 2016 and 2015. For the nine-month periods ended September 30, 2016 and 2015, the compensation cost recognized for equity compensation was $249,000 and $200,000, respectively. The recognized tax benefit for equity compensation expense was $88,000 and $70,000, respectively, for the nine-month periods ended September 30, 2016 and 2015.

At September 30, 2016, the total compensation cost related to nonvested stock option awards not yet recorded was $109,000. This amount will be recognized over the next 3.75 years and the weighted average period of recognizing these costs is expected to be 1.8 years. At September 30, 2016, the total compensation cost related to restricted stock awards not yet recorded was $441,000. This amount will be recognized over the next 4.8 years and the weighted average period of recognizing these costs is expected to be 1.6 years.

Equity Plans Activity

Stock Options

There were no stock options awarded during the three-month and nine-month periods ended September 30, 2016 or the three-month period ended September 30, 2015. There were 26,427 stock options awarded during the nine-month period ended September 30, 2015 at a weighted average exercise price of $9.56. A summary of option activity under the Plans as of September 30, 2016 and changes during the period then ended is presented below:

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at January 1, 2016	248,411	$ 15.19	3.7 years	$ 232
Awarded	—	—	—	—
Exercised	1,500	8.50	—	—
Expired, forfeited or cancelled	59,863	22.45	—	—
Outstanding at September 30, 2016	187,048	$ 12.91	3.9 years	$ 252
Vested at September 30, 2016	142,805	$ 14.11	2.7 years	$ 173
Non-vested at September 30, 2016	44,243	$ 9.05	8.0 years	$ 79

Restricted Stock

There were no shares of restricted stock awarded during the three-month periods ended September 30, 2016 and 2015. There were 29,756 and 45,023 shares of restricted stock awarded during the nine-month periods ended September 30, 2016 and 2015, respectively. Of the 29,756 restricted shares awarded in 2016, 10,094 restricted shares will vest one year from the date of the award, 1,829 vest over five years at 20% per year from the date of the award, and 17,833 are performance based awards that must meet minimum performance criteria before they begin to vest. If the performance metrics are not met, up to 100% of the award may be forfeited and if the performance metrics are exceeded, the awards may be increased by up to 150% of the original award. Of the 45,023 restricted shares awarded in 2015, 12,552 restricted shares vested one year from the date of the award, 11,939 vest over five years at 20% per year from the date of the award, and 20,532 are performance based awards that must meet minimum performance criteria before they begin to vest. If the performance metrics are not met, up to 100% of the award may be forfeited and if the performance metrics are exceeded, the awards may be increased by up to 150% of the original award. Award date fair value is determined by the market price of the Company’s common stock on the date of award ($10.17 on February 17, 2016, $10.40 on May 19, 2016, $9.41 on March 18, 2015, and $9.56 on May 22, 2015).

There were 947 restricted share awards that were fully vested during the three-month period ended September 30, 2016 and 19,166 restricted share awards that were fully vested during the nine-month period ended September 30, 2016. There were 3,274 restricted share awards that were fully vested during the three-month period ended September 30, 2015 and 20,345 restricted share awards that were fully vested during the nine-month period ended September 30, 2015. There were 386 and 1,414 restricted share awards forfeited during the three-month and nine-month periods ended September 30, 2016, respectively, and no restricted share awards forfeited during the three-month and nine-month periods ended September 30, 2015. The intrinsic value of nonvested restricted shares at September 30, 2016 was $723,000.

Restricted Stock	Shares	Weighted Average Award Date Fair Value
Nonvested at January 1, 2016	57,516	$ 9.21
Awarded	29,756	10.26
Less: Vested	19,166	9.10
Less: Expired, forfeited or cancelled	1,414	9.32
Nonvested at September 30, 2016	66,692	$ 9.71

Other Equity Awards

There were no stock appreciation rights; restricted performance stock; unrestricted Company stock; or performance units awarded during the three-month or nine-month month periods ended September 30, 2016 or 2015 or outstanding at September 30, 2016 or December 31, 2015.

The intrinsic value used for stock options and restricted stock awards was derived from the market price of the Company's common stock of $10.84 as of September 30, 2016.

3. COMMITMENTS AND CONTINGENCIES

In the normal course of business there are outstanding various commitments to extend credit which are not reflected in the financial statements, including loan commitments of approximately $23,697,000 and standby letters of credit of approximately $238,000 at September 30, 2016 and loan commitments of approximately $26,730,000 and standby letters of credit of approximately $238,000 at December 31, 2015. Such commitments relate primarily to real estate construction loans, revolving lines of credit and other commercial loans. However, all such commitments will not necessarily culminate in actual extensions of credit by the Company during 2016 as some of these are expected to expire without being fully drawn upon.

Standby letters of credit are commitments issued to guarantee the performance or financial obligation of a client to a third party. These guarantees are issued primarily relating to purchases of inventory, insurance programs, performance obligations to government agencies, or as security for real estate rents by commercial clients and are typically short-term in nature. Credit risk is similar to that involved in extending loan commitments to clients and accordingly, evaluation and collateral requirements similar to those for loan commitments are used. The majority of all such commitments are collateralized. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at September 30, 2016 or December 31, 2015.

4. EARNINGS PER SHARE COMPUTATION

Basic earnings per share is computed by dividing net income by the weighted average common shares outstanding for the period (6,589,125 and 6,800,016 shares for the three-month and nine-month periods ended September 30, 2016, and (7,481,529 and 7,653,109 shares for the three-month and nine-month periods ended September 30, 2015). Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options or restricted stock, result in the issuance of common stock. Diluted earnings per share is computed by dividing net income by the weighted average common shares outstanding for the period plus the dilutive effect of stock based awards. There were 32,515 and 28,108, respectively, dilutive shares for the three-month and nine-month periods ended September 30, 2016 and 19,930 and 14,878, respectively, dilutive shares for the three-month and nine-month periods ended September 30, 2015. For the three-month periods ended September 30, 2016 and 2015, there were 99,308 and 192,106 stock options, respectively, that were excluded from the calculation as they were considered antidilutive. For the nine-month periods ended September 30, 2016 and 2015, there were 99,308 and 192,106 stock options, respectively, that were excluded from the calculation as they were considered antidilutive. Earnings per share is retroactively adjusted for stock dividends and stock splits, if applicable, for all periods presented.

5. INVESTMENT SECURITIES

The amortized cost and estimated fair values of Available-for-Sale and Held-to-Maturity investment securities at September 30, 2016 and December 31, 2015 consisted of the following (dollars in thousands):

Available-for-Sale

	September 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government Agencies and Sponsored Agencies	$224,159	$ 4,739	$ (165)	$228,733
Obligations of states and political subdivisions	22,197	1,017	(41)	23,173
Corporate bonds	1,501	28	—	1,529
Equity securities:				
Corporate stock	49	18	—	67
	$247,906	$ 5,802	$ (206)	$253,502

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government Agencies and Sponsored Agencies	$244,056	$ 3,059	$ (930)	$246,185
Obligations of states and political subdivisions	24,706	1,307	—	26,013

Corporate bonds	1,502	49	—	1,551
Equity securities:				
Corporate stock	51	19	—	70
	$270,315	$ 4,434	$ (930)	$273,819

Net unrealized gains on available-for-sale investment securities totaling $5,596,000 were recorded, net of $2,239,000 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at September 30, 2016. Proceeds and gross realized gains from the sale, call, and impairment of available-for-sale investment securities totaled $5,534,000 and $33,000, respectively, for the three-month period ended September 30, 2016 and for the nine-month period ended September 30, 2016, proceeds and gross realized gains from the sale, call, and impairment of available-for-sale investment securities totaled $13,821,000 and $314,000, respectively. There were no transfers of available-for-sale investment securities for the three-month and nine-month periods ended September 30, 2016.

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Net unrealized gains on available-for-sale investment securities totaling $3,504,000 were recorded, net of $1,401,000 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2015. Proceeds and gross realized gains from the sale and call of available-for-sale investment securities for the three-month period ended September 30, 2015 totaled $8,381,000 and $33,000, respectively, and for the nine-month period ended September 30, 2015 totaled $23,764,000 and $251,000, respectively. There were no transfers of available-for-sale investment securities for the three-month and nine-month periods ended September 30, 2015.

Held-to-Maturity

September 30, 2016

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government Agencies and Sponsored Agencies	$ 508	$ 43	$ —	$ 551

December 31, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government Agencies and Sponsored Agencies	$ 623	$ 46	$ —	$ 669

There were no sales or transfers of held-to-maturity investment securities for the periods ended September 30, 2016 and September 30, 2015. Investment securities with unrealized losses at September 30, 2016 and December 31, 2015 are summarized and classified according to the duration of the loss period as follows (dollars in thousands):

September 30, 2016	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale						
Debt securities:						
U.S. Government Agencies and Sponsored Agencies	$18,319	$ (81)	5,475	(84)	$23,794	$ (165)
Obligations of states and political subdivisions	3,564	(41)	—	—	3,564	(41)
	$21,883	$ (122)	$5,475	$ (84)	$27,358	$ (206)

December 31, 2015	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale						
Debt securities:						
US Government Agencies and Sponsored Agencies	$93,265	$ (813)	$5,251	$ (117)	$98,516	$ (930)
Obligations of states and political subdivisions	—	—	—	—	—	—
	$93,265	$ (813)	$5,251	$ (117)	$98,516	$ (930)

There were no held-to-maturity investment securities with unrealized losses as of September 30, 2016 or December 31, 2015. At September 30, 2016, the Company held 215 securities of which twelve were in a loss position for less than twelve months and three were in a loss position for twelve months or more. Of the twelve securities in a loss position for less than twelve months, nine were U.S. Government Agencies and Sponsored Agencies securities and three were obligations of states or political subdivisions and of the three securities that were in a loss position for greater than twelve months, all three were U.S. Government Agencies and Sponsored Agencies securities.

At December 31, 2015, the Company held 223 securities of which 45 were in a loss position for less than twelve months and three were in a loss position for twelve months or more. Of the 45 securities in a loss position for less than twelve months, all were US Government Agencies and Sponsored Agencies securities and of the three securities that were in a loss position for greater than twelve months, all were US Government Agencies and Sponsored Agencies.

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

The amortized cost and estimated fair values of investment securities at September 30, 2016 by contractual maturity are shown below (dollars in thousands).

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Within one year	$2,577	$2,615		
After one year through five years	2,656	2,768		
After five years through ten years	12,953	13,758		
After ten years	5,512	5,561		
	23,698	24,702		
Investment securities not due at a single maturity date:				
US Government Agencies and Sponsored Agencies	224,159	228,733	$ 508	$ 551
Corporate stock	49	67	—	—
	$247,906	$253,502	$ 508	$ 551

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

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

At September 30, 2016 and December 31, 2015, the recorded investment in nonperforming loans and leases was approximately $778,000 and $1,643,000, respectively. Nonperforming loans and leases include all such loans and leases that are either placed on nonaccrual status or are 90 days past due as to principal or interest but still accrue interest because such loans are well-secured and in the process of collection. The Company considers a loan to be impaired when, based on current information and events, it is probable that it will be unable to collect all amounts due (principal and interest) according to the contractual terms of the original loan agreement. At September 30, 2016, the recorded investment in loans and leases that were considered to be impaired totaled $18,357,000, which includes $753,000 in nonaccrual loans and leases and $17,604,000 in performing loans and leases. Of the total impaired loans of $18,357,000, loans totaling $11,569,000 were deemed to require no specific reserve and loans totaling $6,788,000 were deemed to require a related valuation allowance of $564,000. At December 31, 2015, the recorded investment in loans and leases that were considered to be impaired totaled $21,365,000 and had a related valuation allowance of $899,000.

At September 30, 2016 and December 31, 2015, the balance in other real estate owned ("OREO") was $653,000 and $3,551,000, respectively. At September 30, 2016, the Company did not own any residential OREO properties nor were there any residential properties in the process of foreclosure. During the first quarter of 2016, the Company sold a single commercial property in El Dorado County for a gain of $126,000. Also, during the first quarter the Company obtained an updated appraisal on existing commercial land in Sacramento County, which resulted in a charge to expense of $376,000. The Company did not add any properties to OREO during the first quarter of 2016. During the second quarter of 2016, the Company did not add any properties to OREO or sell any OREO property. During the third quarter of 2016, the Company did not add any properties to OREO and sold one single commercial property in Amador County for a gain of $43,000. The September 30, 2016 OREO balance of $653,000 consisted of one parcel of land zoned for commercial use. Nonperforming assets at September 30, 2016 and December 31, 2015 are summarized as follows:

(dollars in thousands)	September 30, 2016		December 31, 2015	
Nonaccrual loans and leases that are current to terms (less than 30 days past due)	$ 297		$ 379	
Nonaccrual loans and leases that are past due	481		1,264	
Loans and leases past due 90 days and accruing interest	—		—	
Other assets	878		878	
Other real estate owned	653		3,551	
Total nonperforming assets	$ 2,309		$ 6,072	
Nonperforming loans and leases to total loans and leases	0.24	%	0.56	%
Total nonperforming assets to total assets	0.35	%	0.96	%

Impaired loans and leases as of and for the periods ended September 30, 2016 and December 31, 2015 are summarized as follows:

(dollars in thousands)	As of September 30, 2016			As of December 31, 2015		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial	$—	$—	$ —	$—	$—	$ —
Real estate-commercial	11,233	11,931	—	12,269	12,902	—
Real estate-residential	336	423	—	338	338	—
Subtotal	$11,569	$12,354	$ —	$12,607	$13,240	$ —
With an allowance recorded:						
Commercial	$31	$31	$ 3	$121	$121	$ 25
Real estate-commercial	4,053	4,148	366	5,597	5,693	598
Real estate-multi-family	483	483	3	488	488	5
Real estate-residential	1,827	1,827	139	2,114	2,201	204
Agriculture	360	360	30	370	370	38
Consumer	34	34	23	68	68	29

Subtotal	$6,788	$6,883	$ 564	$8,758	$8,941	$ 899
Total:						
Commercial	$31	$31	$ 3	$121	$121	$ 25
Real estate-commercial	15,286	16,079	366	17,866	18,595	598
Real estate-multi-family	483	483	3	488	488	5
Real estate-residential	2,163	2,250	139	2,452	2,539	204
Agriculture	360	360	30	370	370	38
Consumer	34	34	23	68	68	29
	$18,357	$19,237	$ 564	$21,365	$22,181	$ 899

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

	Average Recorded Investments for the three months ended		Average Recorded Investments for the nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Commercial	$ 32	$ 125	$ 33	$ 145
Real estate-commercial	15,369	19,335	15,202	19,749
Real estate-multi-family	484	491	486	493
Real estate-residential	2,169	2,473	2,182	2,511
Agriculture	362	375	365	377
Consumer	35	91	36	77
Total	$ 18,451	$ 22,890	$ 18,304	$ 23,352

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

	Interest Income Recognized for the three months ended		Interest Income Recognized for the nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Commercial	$ —	$ 2	$ 2	$ 7
Real estate-commercial	123	259	567	728
Real estate-multi-family	15	8	25	21
Real estate-residential	24	14	76	69
Agriculture	6	5	16	13
Consumer	—	—	—	—
Total	$ 168	$ 288	$ 686	$ 838

7. TROUBLED DEBT RESTRUCTURINGS

During the three and nine-month periods ended September 30, 2016, there were no loans that were modified as troubled debt restructurings. There were no loans modified as troubled debt restructurings during the three months ended September 30, 2015.

The following table presents loans by class modified as troubled debt restructurings during the nine months ended September 30, 2015 (dollars in thousands):

	Number	Pre-Modification Outstanding Recorded	Post-Modification Outstanding Recorded

	of Loans	Investment	Investment
Troubled debt restructurings:			
Commercial	1	$ 47	$ 47
Real estate - commercial	2	1,645	1,645
Real estate - residential	2	416	416
Consumer	1	23	23
Total	6	$ 2,131	$ 2,131

The troubled debt restructurings described above increased the allowance for loan and lease losses by $151,000 and resulted in no charge-offs during the nine months ended September 30, 2015.

There were no payment defaults on troubled debt restructurings within 12 months following the modification for the three-month and nine-month periods ended September 30, 2016 and September 30, 2015.

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8. ALLOWANCE FOR LOAN AND LEASE LOSSES

The Company's loan and lease portfolio allocated by management's internal risk ratings as of September 30, 2016 and December 31, 2015 are summarized below:

September 30, 2016 (dollars in thousands)	Credit Risk Profile by Internally Assigned Grade				
		Real Estate			
	Commercial	Commercial	Multi-family	Construction	Residential
Grade:					
Pass	$30,334	$169,327	$ 50,442	$ 6,684	$ 13,014
Watch	1,416	21,371	485	10,181	1,797
Special mention	637	3,392	—	—	717
Substandard	2,785	719	—	—	465
Doubtful	—	—	—	—	—
Total	$35,172	$194,809	$ 50,927	$ 16,865	$ 15,993

	Credit Risk Profile by Internally Assigned Grade Other Credit Exposure			
	Leases	Agriculture	Consumer	Total
Grade:				
Pass	$462	$1,875	$ 1,382	$ 273,520
Watch	—	360	405	36,015
Special mention	—	—	221	4,967
Substandard	—	—	62	4,031
Doubtful	—	—	—	—
Total	$462	$2,235	$ 2,070	$ 318,533

December 31, 2015 (dollars in thousands)	Credit Risk Profile by Internally Assigned Grade				
		Real Estate			
	Commercial	Commercial	Multi-family	Construction	Residential
Grade:					
Pass	$32,216	$172,755	$ 23,001	$ 6,371	$ 10,593
Watch	1,073	17,318	493	8,162	2,099
Special mention	—	8,363	—	—	697
Substandard	2,906	1,155	—	—	811
Doubtful or loss	—	—	—	—	—
Total	$36,195	$199,591	$ 23,494	$ 14,533	$ 14,200

	Credit Risk Profile by Internally Assigned Grade Other Credit Exposure			
	Leases	Agriculture	Consumer	Total
Grade:				
Pass	$732	$2,061	$ 2,136	$ 249,865

Watch	—	370	378	29,893
Special mention	—	—	433	9,493
Substandard	—	—	175	5,047
Doubtful or loss	—	—	—	—
Total	$732	$2,431	$ 3,122	$ 294,298

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

September 30, 2016		Real Estate				Other				
(dollars in thousands)	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	Unallocated	Total
Allowance for Loan and Lease Losses										
Beginning balance, January 1, 2016	$860	$2,369	$228	$813	$319	$1	$77	$78	$230	$4,975
Provision for loan losses	(769)	(64)	250	39	(53)	—	(13)	(97)	39	(668)
Loans charged-off	—	(68)	—	—	—	—	—	—	—	(68)
Recoveries	658	14	—	—	—	—	—	72	—	744
Ending balance, September 30, 2016	$749	$2,251	$478	$852	$266	$1	$64	$53	$269	$4,983
Ending balance: Individually evaluated for impairment	$3	$365	$3	$—	$140	$—	$30	$23	$—	$564
Ending balance: Collectively evaluated for impairment	$746	$1,886	$475	$852	$126	$1	$34	$30	$269	$4,419
Loans										
Ending balance	$35,172	$194,809	$50,927	$16,865	$15,993	$462	$2,235	$2,070	$—	$318,533
Ending balance: Individually evaluated for impairment	$31	$15,286	$483	$—	$2,163	$—	$360	$34	$—	$18,357
Ending balance: Collectively evaluated for impairment	$35,141	$179,523	$50,444	$16,865	$13,830	$462	$1,875	$2,036	$—	$300,176
Allowance for Loan and Lease Losses										
Beginning balance, June 30, 2016	$808	$2,647	$329	$725	$283	$1	$73	$60	$206	$5,132
	(644)	(330)	149	127	(17)	—	(9)	(7)	63	(668)

Provision for loan losses										
Loans charged off	—	(68)	—	—	—	—	—	—	—	(68)
Recoveries	585	2	—	—	—	—	—	—	—	587
Ending balance, September 30, 2016	$749	$2,251	$478	$852	$266	$1	$64	$53	$269	$4,983

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December 31, 2015 (dollars in thousands)	Commercial	Real Estate Commercial	Multi-Family	Construction	Residential	Other Leases	Agriculture	Consumer	Unallocated	Total
Ending balance: Individually evaluated for impairment	$25	$598	$5	$—	$204	$—	$38	$29	$—	$899
Ending balance: Collectively evaluated for impairment	$835	$1,771	$223	$813	$115	$1	$39	$49	$230	$4,076
<u>Loans</u>										
Ending balance	$36,195	$199,591	$23,494	$14,533	$14,200	$732	$2,431	$3,122	$—	$294,298
Ending balance: Individually evaluated for impairment	$121	$17,866	$488	$—	$2,452	$—	$370	$68	$—	$21,365
Ending balance: Collectively evaluated for impairment	$36,074	$181,725	$23,006	$14,533	$11,748	$732	$2,061	$3,054	$—	$272,933

September 30, 2015 (dollars in thousands)	Commercial	Real Estate Commercial	Multi-Family	Construction	Residential	Other Leases	Agriculture	Consumer	Unallocated	Total
<u>Allowance for Loan and Lease Losses</u>										
Beginning balance, January 1, 2015	$1,430	$2,317	$130	$583	$399	$2	$62	$124	$254	$5,301
Provision for loan losses	38	(58)	27	160	(133)	—	14	(24)	(24)	—
Loans charged off	(609)	—	—	—	—	(1)	—	(6)	—	(616)
Recoveries	88	41	—	—	113	—	—	2	—	244
Ending balance, September 30, 2015	$947	$2,300	$157	$743	$379	$1	$76	$96	$230	$4,929
<u>Allowance for Loan and Lease Losses</u>										
Beginning balance, June 30, 2015	$1,652	$1,968	$107	$807	$385	$1	$50	$122	$267	$5,359
Provision for loan losses	(161)	331	50	(64)	(119)	—	26	(26)	(37)	—

Loans charged off	(609)	—	—	—	—	—	—	—	—	(609)
Recoveries	65	1	—	—	113	—	—	—	—	179
Ending balance, September 30, 2015	$947	$2,300	$157	$743	$379	$1	$76	$96	$230	$4,929

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The Company's aging analysis of the loan and lease portfolio at September 30, 2016 and December 31, 2015 are summarized below:

September 30, 2016 (dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Past Due Greater Than 90 Days	Total Past Due	Current	Total Loans	Past Due Greater Than 90 Days and Accruing	Nonaccrual
Commercial:								
Commercial	$ —	$ —	$ —	$ —	$ 35,172	$ 35,172	—	$ —
Real estate:								
Commercial	—	—	446	446	194,363	194,809	—	719
Multi-family	—	—	—	—	50,927	50,927	—	—
Construction	—	—	—	—	16,865	16,865	—	—
Residential	—	—	—	—	15,993	15,993	—	—
Other:								
Leases	—	—	—	—	462	462	—	—
Agriculture	—	—	—	—	2,235	2,235	—	—
Consumer	36	35	—	71	1,999	2,070	—	59
Total	$ 36	$ 35	$ 446	$ 517	$ 318,016	$ 318,533	$ —	$ 778

December 31, 2015 (dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Past Due Greater Than 90 Days	Total Past Due	Current	Total Loans	Past Due Greater Than 90 Days and Accruing	Nonaccrual
Commercial:								
Commercial	$ —	$ —	$ 30	$ 30	$ 36,165	$ 36,195	$ —	$ 30
Real estate:								
Commercial	—	359	499	858	198,733	199,591	—	1,155
Multi-family	—	—	—	—	23,494	23,494	—	—
Construction	—	—	—	—	14,533	14,533	—	—
Residential	—	—	338	338	13,862	14,200	—	338
Other:								
Leases	—	—	—	—	732	732	—	—
Agriculture	—	—	—	—	2,431	2,431	—	—
Consumer	367	—	—	367	2,755	3,122	—	120
Total	$ 367	$ 359	$ 867	$ 1,593	$ 292,705	$ 294,298	$ —	$ 1,643

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9. BORROWING ARRANGEMENTS

At September 30, 2016, the Company had $17,000,000 of unsecured short-term borrowing arrangements with two of its correspondent banks. There were no advances under the borrowing arrangements as of September 30, 2016 or December 31, 2015.

The Company has a line of credit available with the Federal Home Loan Bank of San Francisco (the "FHLB") which is secured by pledged mortgage loans and investment securities. Borrowings may include overnight advances as well as loans with terms of up to thirty years. Advances (both short-term and long-term) totaling $14,000,000 were outstanding from the FHLB at September 30, 2016, bearing interest rates ranging from 0.75% to 1.52% and maturing between October 31, 2016 and July 13, 2020. Advances totaling $11,000,000 were outstanding from the FHLB at December 31, 2015, bearing interest rates ranging from 0.45% to 1.91% and maturing between January 19, 2016 and July 12, 2019. Remaining amounts available under the borrowing arrangement with the FHLB at September 30, 2016 and December 31, 2015 totaled $87,263,000 and $78,326,000, respectively. In addition, the Company has a secured borrowing agreement with the Federal Reserve Bank of San Francisco. The borrowing can be secured by pledging selected loans and investment securities. Borrowings generally are short-term including overnight advances as well as loans with terms up to ninety days. Amounts available under this borrowing arrangement at September 30, 2016 and December 31, 2015 were $11,698,000 and $11,371,000, respectively. There were no advances outstanding under this borrowing arrangement as of September 30, 2016 and December 31, 2015.

10. INCOME TAXES

The Company files its income taxes on a consolidated basis with its subsidiaries. The allocation of income tax expense (benefit) represents each entity's proportionate share of the consolidated provision for (benefit from) income taxes.

The Company accounts for income taxes using the balance sheet method, under which deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amounts of assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above, if applicable, is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. The Company recognizes accrued interest and penalties related to unrecognized tax benefits, if applicable, as a component of interest expense in the consolidated statement of income. There have been no unrecognized tax benefits or accrued interest and penalties for the three-month and nine-month periods ended September 30, 2016 and 2015.

Federal and state income taxes for the quarter ended September 30, 2016 increased $182,000 (22.6%) from $807,000 in the third quarter of 2015 to $989,000 in the third quarter of 2016 and increased $252,000 (12.5%) from $2,022,000 in the nine months ended September 30, 2015 to $2,274,000 for the nine months ended September 30, 2016. The combined federal and state effective tax rate for the quarter ended September 30, 2016 was 35.3%, compared to 35.5% for the third quarter of 2015. For the nine months ended September 30, 2016, the combined federal and state effective tax rate was 33.6% compared to 34.7% for the nine months ended September 30, 2015. The lower effective tax rate for both periods in 2016 compared to 2015 resulted from an increase in tax exempt loan interest. Tax exempt loan interest was $189,000 in the third quarter of 2016 compared to $99,000 in the third quarter of 2015 and tax exempt loan interest was $534,000 in the first nine months of 2016 compared to $222,000 in the first nine months of 2015. The benefit from tax exempt loan interest was partially offset by higher taxable income in both periods as well. Taxable income was $2,802,000 in the third quarter of 2016 compared to $2,276,000 in the third quarter of 2015 and taxable income was $6,763,000 in the first nine months of 2016 compared to $5,833,000 in the first nine months of 2015.

11. FAIR VALUE MEASUREMENTS

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of September 30, 2016 and December 31, 2015. They indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. 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.

Estimated fair values are disclosed for financial instruments for which it is practicable to estimate fair value. These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

The carrying amounts and estimated fair values of the Company's financial instruments are as follows (dollars in thousands):

	Carrying	Fair Value Measurements Using:			
September 30, 2016	Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$43,094	$43,094	$—	$—	$43,094
Interest-bearing deposits in banks	999	—	999	—	999
Available-for-sale securities	253,502	23	253,479	—	253,502
Held-to-maturity securities	508	—	551	—	551
FHLB stock	3,779	N/A	N/A	N/A	N/A
Net loans and leases:	313,302	—	—	316,221	316,221
Accrued interest receivable	1,792	—	866	926	1,792
Financial liabilities:					
Deposits:					
Noninterest-bearing	$209,586	$209,586	$—	$—	$209,586

Savings	60,605	60,605	—	—	60,605
Money market	131,655	131,655	—	—	131,655
NOW accounts	61,398	61,398	—	—	61,398
Time Deposits	82,921	—	83,429	—	83,429
Short-term borrowings	5,000	5,000	—	—	5,000
Long-term borrowings	9,000	—	9,080	—	9,080
Accrued interest payable	40	—	40	—	40

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December 31, 2015	Carrying Amount	Fair Value Measurements Using: Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$23,727	$23,727	$—	$—	$23,727
Interest-bearing deposits in banks	750	—	752	—	752
Available-for-sale securities	273,819	24	273,795	—	273,819
Held-to-maturity securities	623	—	669	—	669
FHLB stock	3,779	N/A	N/A	N/A	N/A
Net loans and leases:	289,102	—	—	292,444	292,444
Accrued interest receivable	1,885	—	1,077	808	1,885
Financial liabilities:					
Deposits:					
Noninterest-bearing	$190,548	$190,548	$—	$—	$190,548
Savings	59,061	59,061	—	—	59,061
Money market	135,186	135,186	—	—	135,186
NOW accounts	61,324	61,324	—	—	61,324
Time Deposits	84,571	—	85,165	—	85,165
Short-term borrowings	3,500	3,500	—	—	3,500
Long-term borrowings	7,500	—	7,502	—	7,502
Accrued interest payable	60	—	60	—	60

Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the fair values presented.

The following methods and assumptions were used by the Company to estimate the fair values of its financial instruments at September 30, 2016 and December 31, 2015:

Cash and due from banks: The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

Interest-bearing deposits in banks: The fair values of interest-bearing deposits in banks are estimated by discounting their future cash flows using rates at each reporting date for instruments with similar remaining maturities offered by comparable financial institutions and are classified as Level 2.

Investment securities: For investment securities, fair values are based on quoted market prices, where available, and are classified as Level 1. If quoted market prices are not available, fair values are estimated using quoted market prices for similar securities and indications of value provided by brokers and are classified as Level 2.

FHLB stock: It is not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability.

Loans and leases: Fair values of loans, excluding loans held for sale, are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other 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 also resulting in a Level 3 classification. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

Deposits: The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook 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 amount) resulting in a Level 1 classification. For time deposits, the fair values for fixed rate certificates of deposit are estimated using a discounted cash flow methodology that applies market interest rates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Short-term and long-term borrowings: The fair value of short-term borrowings is estimated to be the carrying amount and is classified as Level 1. The fair value of long-term borrowings is estimated using a discounted cash flow analysis using interest rates currently available for similar debt instruments and are classified as Level 2.

Accrued interest receivable and payable: The carrying amount of accrued interest receivable approximates fair value resulting in a Level 3 classification and the carrying amount of accrued interest payable approximates fair value resulting in a Level 2 classification.

Off-balance sheet instruments: Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments was not material at September 30, 2016 and December 31, 2015.

Assets and liabilities measured at fair value on a recurring and non-recurring basis along with any related gain or loss recognized in the income statement due to fair value changes are presented in the following table:

Description		Fair Value Measurements Using			Total Gains
(dollars in thousands)	Fair Value	Level 1	Level 2	Level 3	(Losses)
September 30, 2016					
Assets and liabilities measured on a recurring basis:					
Available-for-sale securities:					
US Government Agencies and Sponsored Agencies	$ 228,733	$ —	$ 228,733	$ —	$ —
Obligations of states and political subdivisions	23,173	—	23,173	—	—
Corporate bonds	1,529	—	1,529	—	—
Corporate stock	67	23	44	—	—
Total recurring	$ 253,502	$ 23	$ 253,479	$ —	$ —
Assets and liabilities measured on a nonrecurring basis:					
Impaired loans:					
Real estate:					
Commercial	$ 4,271	$ —	$ —	$ 4,271	$ —
Residential	336	—	—	336	(68)
Other real estate owned Land	653	—	—	653	(376)
Total nonrecurring	$ 5,260	$ —	$ —	$ 5,260	$ (444)

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Description		Fair Value Measurements Using			Total Gains
(dollars in thousands)	Fair Value	Level 1	Level 2	Level 3	(Losses)
December 31, 2015					
Assets and liabilities measured on a recurring basis:					
Available-for-sale securities:					
US Government Agencies and Sponsored Agencies	$ 246,185	$ —	$ 246,185	$ —	$ —
Corporate Debt securities	1,551	—	1,551		
Obligations of states and political subdivisions	26,013	—	26,013	—	—
Corporate stock	70	24	46	—	—
Total recurring	$ 273,819	$ 24	$ 273,795	$ —	$ —
Assets and liabilities measured on a nonrecurring basis:					
Impaired loans:					
Real estate:					
Commercial	$ 3,900	$ —	$ —	$ 3,900	$ (334)
Other real estate owned					
Commercial	2,522	—	—	2,522	—
Land	1,029	—	—	1,029	—
Total nonrecurring	$ 7,451	$ —	$ —	$ 7,451	$ (334)

There were no significant transfers between Levels 1 and 2 during the three-month and nine-month periods ended September 30, 2016 or the twelve months ended December 31, 2015.

The following methods were used to estimate the fair value of each class of financial instrument above:

Available-for-sale securities – Fair values for investment securities are based on quoted market prices, if available, and are considered Level 1, or evaluated using pricing models that vary by asset class and incorporate available trade, bid and other market information and are considered Level 2. Pricing applications apply available information, as applicable, through processes such as benchmark curves, benchmarking to like securities, sector groupings and matrix pricing.

Impaired loans – The fair value of collateral dependent impaired loans adjusted for specific allocations of the allowance for loan losses is generally based on recent real estate appraisals and/or evaluations. These appraisals and/or evaluations may utilize a single valuation approach or a combination of approaches including comparable sales, cost and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income and other available data. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. The valuation technique used for all Level 3 nonrecurring impaired loans is the sales comparison approach less a reserve for past due taxes and selling costs ranging from 8% to 10%.

Other real estate owned – Certain commercial and residential real estate properties classified as OREO are measured at fair value, less costs to sell. Fair values are based on recent real estate appraisals and/or evaluations. These appraisals and/or evaluations may use a single valuation approach or a combination of approaches including comparable sales, cost and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income and other available data. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. The valuation technique used for all Level 3 nonrecurring OREO is the sales comparison approach less selling costs ranging from 8% to 10%.

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12. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In January 2016, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“ASU”) No. 2016-01, “*Recognition and Measurement of Financial Assets and Financial Liabilities.*” This ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments by making targeted improvements to GAAP as follows: (1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) 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; (2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; (3) eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (4) eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (5) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (6) require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (7) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (8) clarify that an 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 No. 2016-01 is effective for interim and annual reporting periods beginning after December 15, 2017. Early application is permitted as of the beginning of the fiscal year of adoption only for provisions (3) and (6) above. Early adoption of the other provisions mentioned above is not permitted. The Company has performed a preliminary evaluation of the provisions of ASU No. 2016-01. Based on this evaluation, the Company has determined that ASU No. 2016-01 is not expected to have a material impact on the Company’s financial position, results of operations or cash flows.

In February 2016, the FASB issued ASU No. 2016-02, “*Leases.*” Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases): 1) a lease liability, which is the present value of a lessee’s obligation to make lease payments, and 2) a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Lessor accounting under the new guidance remains largely unchanged as it is substantially equivalent to existing guidance for sales-type leases, direct financing leases, and operating leases. Leveraged leases have been eliminated, although lessors can continue to account for existing leveraged leases using the current accounting guidance. Other limited changes were made to align lessor accounting with the lessee accounting model and the new revenue recognition standard. All entities will classify leases to determine how to recognize lease-related revenue and expense. Quantitative and qualitative disclosures will be required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The intention is to require enough information to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an entity’s leasing activities. ASU No. 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. All entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. They have the option to use certain relief; full retrospective application is prohibited. The Company is currently evaluating the provisions of ASU No. 2016-02 and will be closely monitoring developments and additional guidance to determine the potential impact the new standard will have on the Company’s Consolidated Financial Statements.

In March 2016, the FASB issued ASU No. 2016-09, "*Improvements to Employee Share-Based Payment Accounting.*" This ASU includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. Some of the key provisions of this new ASU include: (1) companies will no longer record excess tax benefits and certain tax deficiencies in additional paid-in capital ("APIC"). Instead, they will record all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement, and APIC pools will be eliminated. The guidance also eliminates the requirement that excess tax benefits be realized before companies can recognize them. In addition, the guidance requires companies to present excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity; (2) increase the amount an employer can withhold to cover income taxes on awards and still qualify for the exception to liability classification for shares used to satisfy the employer's statutory income tax withholding obligation. The new guidance will also require an employer to classify the cash paid to a tax authority when shares are withheld to satisfy its statutory income tax withholding obligation as a financing activity on its statement of cash flows (current guidance did not specify how these cash flows should be classified); and (3) permit companies to make an accounting policy election for the impact of forfeitures on the recognition of expense for share-based payment awards. Forfeitures can be estimated, as required today, or recognized when they occur. ASU No. 2016-09 is effective for interim and annual reporting periods beginning after December 15, 2016. Early adoption is permitted, but all of the guidance must be adopted in the same period. The Company is currently evaluating the provisions of ASU No. 2016-09 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements.

In June 2016, the FASB issued ASU No. 2016-13, *"Measurement of Credit Losses on Financial Instruments."* This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. In issuing the standard, the FASB is responding to criticism that today's guidance delays recognition of credit losses. The standard will replace today's "incurred loss" approach with an "expected loss" model. The new model, referred to as the current expected credit loss ("CECL") model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for-sale ("AFS") debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. The ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU No. 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted for interim and annual reporting periods beginning after December 15, 2018. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). The Company is currently evaluating the provisions of ASU No. 2016-13 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following is management's discussion and analysis of the significant changes in American River Bankshares' (the "Company") balance sheet accounts between December 31, 2015 and September 30, 2016 and its income and expense accounts for the three-month and nine-month periods ended September 30, 2016 and 2015. The discussion is designed to provide a better understanding of significant trends related to the Company's financial condition, results of operations, liquidity, capital resources and interest rate sensitivity. This discussion and supporting tables and the consolidated financial statements and related notes appearing elsewhere in this report are unaudited. Interest income and net interest income are presented on a fully taxable equivalent basis (FTE) within management's discussion and analysis. Certain matters discussed or incorporated by reference in this Quarterly Report on Form 10-Q including, but not limited to, matters described in "Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations," are "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, Section 27A of the Securities Act of 1933, as amended, and subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements may contain words related to future projections including, but not limited to, words such as "believe," "expect," "anticipate," "intend," "may," "will," "shoul "could," "would," and variations of those words and similar words that are subject to risks, uncertainties and other factors that could cause actual results to differ significantly from those projected. Factors that could cause or contribute to such differences include, but are not limited to, the following:

- the legislation promulgated by the United States Congress and actions taken by governmental agencies, including the United States Department of the Treasury, to deal with challenges to the U.S. financial system;
- the risks presented by economic volatility and recession, which could adversely affect credit quality, collateral values, including real estate collateral, investment values, liquidity and loan originations and loan portfolio delinquency rates;
- variances in the actual versus projected growth in assets and return on assets;
- potential loan and lease losses;
- potential expenses associated with resolving nonperforming assets as well as regulatory changes;
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