UNITED SECURITY BANCSHARES
Form 10-Q
August 06, 2015
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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, 2015
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, 2015: 15,735,131

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PART I. Financial Information

United Security Bancshares and Subsidiaries
Consolidated Balance Sheets – (unaudited)
June 30, 2015 and December 31, 2014

(in thousands except shares)	June 30, 2015	December 31, 2014
Assets		
Cash and non-interest bearing deposits in other banks	$22,708	$21,348
Cash and due from Federal Reserve Bank	59,445	82,229
Cash and cash equivalents	82,153	103,577
Interest-bearing deposits in other banks	1,525	1,522
Investment securities available for sale (at fair value)	42,779	48,301
Loans	503,747	457,919
Unearned fees and unamortized loan origination costs, net	383	(324)
Allowance for credit losses	(11,552)	(10,771)
Net loans	492,578	446,824
Accrued interest receivable	1,996	1,927
Premises and equipment – net	11,193	11,550
Other real estate owned	14,010	14,010
Goodwill	4,488	4,488
Cash surrender value of life insurance	17,975	17,717
Investment in limited partnerships	929	871
Deferred income taxes - net	6,855	6,853
Other assets	5,839	5,529
Total assets	$682,320	$663,169
Liabilities & Shareholders' Equity		
Liabilities		
Deposits		
Noninterest bearing	$235,498	$215,439
Interest bearing	344,463	349,934
Total deposits	579,961	565,373
Accrued interest payable	28	40
Accounts payable and other liabilities	6,411	4,815
Junior subordinated debentures (at fair value)	9,916	10,115
Total liabilities	596,316	580,343
Shareholders' Equity		
Common stock, no par value 20,000,000 shares authorized, 15,735,131 issued and outstanding at June 30, 2015, and 15,425,086 at December 31, 2014	50,914	49,271
Retained earnings	35,392	33,730
Accumulated other comprehensive loss	(302)	(175)
Total shareholders' equity	86,004	82,826
Total liabilities and shareholders' equity	$682,320	$663,169

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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)	2015	2014	2015	2014
Interest Income:				
Loans, including fees	$6,634	$5,940	$12,913	$11,415
Investment securities – AFS – taxable	166	233	380	461
Interest on deposits in FRB	37	64	83	147
Interest on deposits in other banks	1	1	3	3
Total interest income	6,838	6,238	13,379	12,026
Interest Expense:				
Interest on deposits	253	259	512	521
Interest on other borrowings	59	63	117	124
Total interest expense	312	322	629	645
Net Interest Income	6,526	5,916	12,750	11,381
(Recovery of Provision) Provision for Credit Losses	(2)	(93)	457	(140)
Net Interest Income after (Recovery of Provision) Provision for Credit Losses	6,528	6,009	12,293	11,521
Noninterest Income:				
Customer service fees	866	888	1,699	1,682
Increase in cash surrender value of bank-owned life insurance	130	128	258	255
Gain (loss) on fair value of financial liability	324	216	199	(129)
Gain on sale of investment in limited partnership	—	691	—	691
Gain on sale of fixed asset	—	25	—	25
Other	226	157	311	298
Total noninterest income	1,546	2,105	2,467	2,822
Noninterest Expense:				
Salaries and employee benefits	2,273	2,279	4,704	4,805
Occupancy expense	1,034	956	1,974	1,829
Data processing	28	28	59	69
Professional fees	252	327	600	507
Regulatory assessments	225	239	471	472
Director fees	68	61	124	117
Amortization of intangibles	—	15	—	62
Correspondent bank service charges	19	30	38	59
Loss on California tax credit partnership	30	24	60	47
Net cost on operation of OREO	126	84	194	364
Other	627	701	1,166	1,207
Total noninterest expense	4,682	4,744	9,390	9,538
Income Before Provision for Taxes	3,392	3,370	5,370	4,805
Provision for Taxes on Income	1,329	1,323	2,079	1,849
Net Income	$2,063	$2,047	$3,291	$2,956
Net Income per common share				
Basic	$0.13	$0.13	$0.21	$0.19
Diluted	$0.13	$0.13	$0.21	$0.19
Shares on which net income per common shares were based				

Basic	15,735,131	15,710,238	15,735,131	15,710,238
Diluted	15,737,009	15,719,955	15,737,007	15,718,777

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

(In thousands)	Three Months Ended June 30, 2015	Three Months Ended June 30, 2014	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
Net Income	$2,063	$2,047	$3,291	$2,956
Unrealized holdings (losses) gains on securities	(367)	57	(247)	8
Unrealized gains on unrecognized post-retirement costs	17	15	36	31
Other comprehensive (loss) income, before tax	(350)	72	(211)	39
Tax benefit (expense) related to securities	147	(23)	99	(3)
Tax expense related to unrecognized post-retirement costs	(7)	(6)	(15)	(13)
Total other comprehensive (loss) income	(210)	43	(127)	23
Comprehensive income	$1,853	$2,090	$3,164	$2,979

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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 Income (Loss)	Total
Balance December 31, 2013	14,799,888	$45,778	$30,884	$(119)	$76,543
Other comprehensive loss				23	23
Common stock dividends	297,394	1,685	(1,685)		—
Stock-based compensation expense		16			16
Net income			2,956		2,956
Balance June 30, 2014	15,097,282	$47,479	$32,155	$(96)	$79,538
Other comprehensive loss				(79)	(79)
Common stock dividends	303,882	1,685	(1,685)		—
Common stock issuance	23,922	95			95
Stock-based compensation expense		12			12
Net income			3,260		3,260
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

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

(In thousands)	Six months ended June 30, 2015	2014
Cash Flows From Operating Activities:		
Net Income	$3,291	$2,956
Adjustments to reconcile net income:to cash provided by operating activities:		
Provision (recovery of provision) for credit losses	457	(140)
Depreciation and amortization	717	667
Amortization of investment securities	139	120
Accretion of investment securities	(14)	(18)
Increase in accrued interest receivable	(69)	(183)
Decrease in accrued interest payable	(12)	(5)
Decrease in accounts payable and accrued liabilities	(342)	(1,172)
(Decrease) increase in unearned fees	(707)	455
Increase in income taxes payable	1,997	1,898
Stock-based compensation expense	14	15
Benefit for deferred income taxes	82	(53)
Gain on sale of other real estate owned	1	(107)
Increase in cash surrender value of bank-owned life insurance	(258)	(255)
Loss on fair value option of financial liabilities	(199)	129
Loss on tax credit limited partnership interest	60	47
Amortization of CDI	—	62
Gain on sale of investment in limited partnership	—	(691)
Gain on sale of premises and equipment	—	(25)
Net decrease in other assets	(185)	(192)
Net cash provided by operating activities	4,972	3,508
Cash Flows From Investing Activities:		
Net increase in interest-bearing deposits with banks	(3)	(3)
Purchase of correspondent bank stock	(147)	(97)
Purchases of available-for-sale securities	—	(10,192)
Maturities and calls of available-for-sale securities	2,000	—
Principal payments of available-for-sale securities	3,149	2,456
Net increase in loans	(45,546)	(25,473)
Cash proceeds from sales of other real estate owned	41	1,017
Investment in limited partnership	(118)	(70)
Cash proceeds from sale of investment in limited partnership	—	1,250
Capital expenditures of premises and equipment	(360)	(485)
Net cash used in investing activities	(40,984)	(31,597)
Cash Flows From Financing Activities:		
Net increase in demand deposits and savings accounts	18,119	12,422
Net (decrease) increase in certificates of deposit	(3,531)	1,154
Net cash provided by financing activities	14,588	13,576
Net decrease in cash and cash equivalents	(21,424)	(14,513)

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Cash and cash equivalents at beginning of period	103,577	135,212
Cash and cash equivalents at end of period	$82,153	$120,699

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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 2014 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 January 2014, FASB issued ASU 2014-04, Receivables - Troubled Debt Restructurings by Creditors. The amendments in this ASU clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this ASU using either a modified retrospective transition method or a prospective transition method. Early adoption is permitted. The adoption of this update did not have a significant impact on the Company’s consolidated financial statements.

In January 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-01 Accounting for Investments in Qualified Affordable Housing Projects. This ASU provides "guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit." It allows the proportional amortization method to be used by a reporting entity if certain conditions are met. The ASU also defines when a qualified affordable housing project through a limited liability entity should be tested for impairment. If a qualified affordable housing project does not meet the conditions for using the proportional amortization method, the investment should be accounted for using an equity method investment or a cost method investment. The ASU is effective for fiscal years beginning after December 15, 2014, and interim periods therein. The Company will continue to account for our low-income housing tax credit investments using the equity method subsequent to the adoption of ASU 2014-01 and does not expect any impact on the Company's consolidated financial statements.

2. Investment Securities

Following is a comparison of the amortized cost and fair value of securities available-for-sale, as of June 30, 2015 and December 31, 2014:

(in 000's) June 30, 2015 Securities available for sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
U.S. Government agencies	$10,748	$379	$—	$11,127
U.S. Government collateralized mortgage obligations	27,733	239	(135)	27,837
Mutual Funds	4,000	—	(185)	3,815
Total securities available for sale	$42,481	$618	$(320)	$42,779

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(in 000's) December 31, 2014 Securities available for sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
U.S. Government agencies	$12,097	$399	$—	$12,496
U.S. Government collateralized mortgage obligations	31,659	336	(13)	31,982
Mutual Funds	4,000	—	(177)	3,823
Total securities available for sale	$47,756	$735	$(190)	$48,301

The amortized cost and fair value of securities available for sale at June 30, 2015, 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.

	June 30, 2015	
(in 000's)	Amortized Cost	Fair Value (Carrying Amount)
Due in one year or less	$4,000	$3,815
Due after one year through five years	21	21
Due after five years through ten years	—	—
Due after ten years	10,727	11,106
Collateralized mortgage obligations	27,733	27,837
	$42,481	$42,779

There were no realized gains or losses on sales of available-for-sale securities for the three and six month periods ended June 30, 2015 and June 30, 2014. There were no other-than-temporary impairment losses for the three and six month periods ended June 30, 2015 and June 30, 2014.

At June 30, 2015, available-for-sale securities with an amortized cost of approximately $25,493,197 (fair value of $25,945,316) were pledged as collateral for FHLB borrowings and public funds balances.

The Company had no held-to-maturity or trading securities at June 30, 2015 or December 31, 2014.

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.

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The following summarizes temporarily impaired investment securities:

(in 000's)	Less than 12 Months		12 Months or More		Total	
June 30, 2015 Securities available for sale:	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses
U.S. Government agencies	$—	$—	$—	$—	$—	$—
U.S. Government agency collateral mortgage obligations	12,575	(135)	—	—	12,575	(135)
Mutual Funds	—	—	3,815	(185)	3,815	(185)
Total impaired securities	$12,575	$(135)	$3,815	$(185)	$16,390	$(320)
December 31, 2014 Securities available for sale:						
U.S. Government agencies	$—	$—	$—	$—	$—	$—
U.S. Government agency collateral mortgage obligations	6,478	(13)	—	—	6,478	(13)
Mutual Funds	—	—	3,823	(177)	3,823	(177)
Total impaired securities	$6,478	$(13)	$3,823	$(177)	$10,301	$(190)

Temporarily impaired securities at June 30, 2015, were comprised of one mutual fund and six U.S. government agency collateral mortgage obligations.

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 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

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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, 2015, the decline in market value of the impaired mutual fund and collateralized mortgage obligation securities is attributable to changes in interest rates, and not credit quality. Because the Company does not have the intent to sell these impaired securities and it is not more likely than not that it will be required to sell these securities before its anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired at June 30, 2015.

3. Loans

Loans are comprised of the following:

(in 000's)	June 30, 2015	December 31, 2014
Commercial and Business Loans	$59,596	$60,422
Government Program Loans	1,782	1,947
Total Commercial and Industrial	61,378	62,369
Real Estate – Mortgage:		
Commercial Real Estate	163,467	154,672
Residential Mortgages	75,845	59,095
Home Improvement and Home Equity loans	994	1,110
Total Real Estate Mortgage	240,306	214,877
Real Estate Construction and Development	157,527	137,158
Agricultural	33,820	31,713
Installment	10,716	11,802
Total Loans	$503,747	$457,919

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 12.2% of total loans at June 30, 2015 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 47.7% of total loans at June 30, 2015, 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.

- 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

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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 31.3% of total loans at June 30, 2015, 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 6.7% of total loans at June 30, 2015 and are generally secured by land, equipment, inventory and receivables. Repayment is from the cash flow of the borrower.

Installment loans represent 2.1% of total loans at June 30, 2015 and generally consist of 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, 2015 and December 31, 2014, these financial instruments include commitments to extend credit of $103,021,000 and $105,434,000, respectively, and standby letters of credit of $3,853,000 and $3,800,000, 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, 2015 (in 000's):

June 30, 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	$118	$—	$962	$1,080	$58,516	$59,596	$—
Government Program Loans	19	—	—	19	1,763	1,782	—
Total Commercial and Industrial	137	—	962	1,099	60,279	61,378	—
Commercial Real Estate Loans	761	—	—	761	162,706	163,467	—
Residential Mortgages	—	183	85	268	75,577	75,845	—
Home Improvement and Home Equity Loans	30	—	—	30	964	994	—
Total Real Estate Mortgage	791	183	85	1,059	239,247	240,306	—
Real Estate Construction and Development Loans	—	—	—	—	157,527	157,527	—
Agricultural Loans	—	—	—	—	33,820	33,820	—
Consumer Loans	—	—	450	450	10,056	10,506	—
Overdraft Protection Lines	—	—	—	—	79	79	—
Overdrafts	—	—	—	—	131	131	—
Total Installment	—	—	450	450	10,266	10,716	—
Total Loans	$928	$183	$1,497	$2,608	$501,139	$503,747	$—

The following is a summary of delinquent loans at December 31, 2014 (in 000's):

December 31, 2014	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	$962	$—	$—	$962	$59,460	$60,422	$—
Government Program Loans	445	—	—	445	1,502	1,947	—
Total Commercial and Industrial	1,407	—	—	1,407	60,962	62,369	—
Commercial Real Estate Loans	463	—	—	463	154,209	154,672	—
Residential Mortgages	—	90	162	252	58,843	59,095	—
Home Improvement and Home Equity Loans	43	—	42	85	1,025	1,110	—
	506	90	204	800	214,077	214,877	—

Total Real Estate Mortgage							
Real Estate Construction and Development Loans	—	—	—	—	137,158	137,158	—
Agricultural Loans	—	—	—	—	31,713	31,713	—
Consumer Loans	67	—	—	67	11,428	11,495	—
Overdraft Protection Lines	—	—	—	—	92	92	—
Overdrafts	—	—	—	—	215	215	—
Total Installment	67	—	—	67	11,735	11,802	—
Total Loans	$1,980	$90	$204	$2,274	$455,645	$457,919	$—

Nonaccrual Loans

Commercial, construction and commercial real estate loans are placed on non-accrual 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 non-accrual status and the accrual of interest for financial statement purposes is discontinued. Previously accrued but unpaid interest is reversed and charged against interest income.

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

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

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

Cash basis: This method is only used if the recorded investment or total contractual amount is expected to be fully collectible, under which circumstances the subsequent payments of interest 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 $8,358,000 and $9,935,000 at June 30, 2015 and December 31, 2014, respectively. There were no remaining undisbursed commitments to extend credit on nonaccrual loans at June 30, 2015 or December 31, 2014.

The following is a summary of nonaccrual loan balances at June 30, 2015 and December 31, 2014 (in 000's).

	June 30, 2015	December 31, 2014
Commercial and Business Loans	$962	$12
Government Program Loans	368	421
Total Commercial and Industrial	1,330	433
Commercial Real Estate Loans	1,302	3,145
Residential Mortgages	268	1,174
Home Improvement and Home Equity Loans	—	42
Total Real Estate Mortgage	1,570	4,361

Real Estate Construction and Development Loans	5,008	5,141
Agricultural Loans	—	—
Consumer Loans	450	—
Overdraft Protection Lines	—	—
Overdrafts	—	—
Total Installment	450	—
Total Loans	$8,358	$9,935

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Impaired Loans

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

The Company applies its normal loan review procedures in making judgments regarding probable losses and loan impairment. The Company evaluates for impairment those loans on non-accrual status, graded doubtful, graded substandard or those that are troubled debt restructures. The primary basis for inclusion in impaired status under 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 restructuring. For income recognition, the existing nonaccrual and troubled debt restructuring policies are applied to impaired loans. Generally, except for certain troubled debt restructurings which are performing under the restructure agreement, the Company does not recognize interest income received on impaired loans, but reduces the carrying amount of the loan for financial reporting purposes.

Loans other than certain 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, 2015 (in 000's).

June 30, 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	$1,668	$516	$1,153	$1,669	$1,002	$1,516	$54
Government Program Loans	368	368	—	368	—	392	16
Total Commercial and Industrial	2,036	884	1,153	2,037	1,002	1,908	70
Commercial Real Estate Loans	1,302	—	1,302	1,302	441	2,364	6
Residential Mortgages	3,906	1,419	2,496	3,915	150	4,270	124
Home Improvement and Home Equity Loans	—	—	—	—	—	28	—
Total Real Estate Mortgage	5,208	1,419	3,798	5,217	591	6,662	130
Real Estate Construction and Development Loans	6,195	5,482	718	6,200	146	6,286	178
Agricultural Loans	24	25	—	25	—	28	4
Consumer Loans	1,100	—	1,103	1,103	583	1,039	9
Overdraft Protection Lines	—	—	—	—	—	—	—
Overdrafts	—	—	—	—	—	—	—
Total Installment	1,100	—	1,103	1,103	583	1,039	9
Total Impaired Loans	$14,563	$7,810	$6,772	$14,582	$2,322	$15,923	$391

(1) The recorded investment in loans includes accrued interest receivable of $19,000.
(2) Information is based on the six month period ended June 30, 2015.

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The following is a summary of impaired loans at December 31, 2014 (in 000's).

December 31, 2014	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	$996	$770	$230	$1,000	$64	$847	$76
Government Program Loans	421	421	—	421	—	250	28
Total Commercial and Industrial	1,417	1,191	230	1,421	64	1,097	104
Commercial Real Estate Loans	3,145	1,794	1,351	3,145	478	5,765	244
Residential Mortgages	4,315	1,474	2,852	4,326	170	4,564	188
Home Improvement and Home Equity Loans	42	42	—	42	—	11	3
Total Real Estate Mortgage	7,502	3,310	4,203	7,513	648	10,340	435
Real Estate Construction and Development Loans	6,367	6,371	—	6,371	—	3,362	209
Agricultural Loans	32	32	—	32	—	37	9
Consumer Loans	695	655	45	700	3	209	37
Overdraft Protection Lines	—	—	—	—	—	—	—
Overdrafts	—	—	—	—	—	—	—
Total Installment	695	655	45	700	3	209	37
Total Impaired Loans	$16,013	$11,559	$4,478	$16,037	$715	$15,045	$794

(1) The recorded investment in loans includes accrued interest receivable of $24,000.
(2) Information is based on the twelve month period ended December 31, 2014.

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, 2015 and 2014 was $15,867,000 and $15,073,000, respectively. Interest income recognized on impaired loans for the quarters ended June 30, 2015 and 2014 was approximately $144,000 and $132,000, respectively. For impaired nonaccrual loans, interest income recognized under a cash-basis method of accounting was approximately $41,000 and $58,000 for the quarters ended June 30, 2015 and 2014, respectively.

The average recorded investment in impaired loans for the six months ended June 30, 2015 and 2014 was $15,923,000 and $14,877,000, respectively. Interest income recognized on impaired loans for the six months ended June 30, 2015 and 2014 was approximately $391,000 and $287,000, respectively. For impaired nonaccrual loans, interest income recognized under a cash-basis method of accounting was approximately $200,000 and $147,000 for the six months ended June 30, 2015 and 2014, 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:

	Three Months Ended June 30, 2015				
($ in 000's)	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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	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	—	$—

	Three Months Ended June 30, 2014				
($ in 000's)	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	$50	$49	1	$—
Government Program Loans	1	544	539	—	—
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	2	$594	$588	1	$—

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($ in 000's)	Six Months Ended June 30, 2014				
	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	$50	$49	1	$—
Government Program Loans	1	544	539	1	—
Commercial Real Estate Term Loans	—	—	—	—	—
Single Family Residential Loans	—	—	—	2	495
Home Improvement and Home Equity Loans	—	—	—	—	—
Real Estate Construction and Development Loans	—	—	—	2	394
Agricultural Loans	—	—	—	—	—
Consumer Loans	—	—	—	—	—
Overdraft Protection Lines	—	—	—	—	—
Total Loans	2	$594	$588	6	$889

The Company makes various types of concessions when structuring TDRs including rate reductions, payment extensions, and forbearance. At June 30, 2015, the Company had 28 restructured loans totaling $12,459,000 as compared to 33 restructured loans totaling $15,000,000 at December 31, 2014.

The following tables summarize TDR activity by loan category for the six months ended June 30, 2015 and June 30, 2014 (in 000's).

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	—	—	256	—	—	—	—	256
Principal reductions	(331)	(1,411)	(843)	—	(159)	(7)	(46)	(2,797)
Ending balance	$975	$1,302	$3,638	$—	$5,870	$25	$649	$12,459
Allowance for loan loss	$18	$441	$150	$—	$80	$—	$132	$821

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Six Months Ended June 30, 2014	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Improvement and Home Equity	Real Estate Construction Development	Agricultural	Installment & Other	Total
Beginning balance	$675	$1,468	$5,273	$ —	$ 1,551	$44	$48	$9,059
Defaults	—	—	(495)	—	(394)	—	—	(889)
Additions	588	—	—	—	—	—	—	588
Principal reductions	(156)	(58)	(242)	—	(667)	(6)	(2)	(1,131)
Ending balance	$1,107	$1,410	$4,536	$ —	$ 490	$38	$46	$7,627
Allowance for loan loss	$27	$467	$231	$ —	$ —	$—	$3	$728

The following tables summarize TDR activity by loan category for the quarters ended June 30, 2015 and June 30, 2014.

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	Lease Financing	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	$ 0	$ 80	$—	$132	$—	$821

Three months ended June 30, 2014	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Improvement and Home Equity	Real Estate Construction Development	Agricultural	Installment & Other	Lease Financing	Total
Beginning balance	$660	$1,445	$4,813	$ —	$ 885	$41	$47	$—	$7,891
Defaults	—	—	—	—	—	—	—	—	—
Additions	588	—	—	—	—	—	—	—	588

Principal reductions	(141)	(35)	(277)	—	(395)	(3)	(1)	—	(852)
Ending balance	$1,107	$1,410	$4,536	$ —	$ 490	$38	$46	$—	$7,627
Allowance for loan loss	$27	$467	$231	$ —	$ —	$—	$3	$—	$728

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, 2015 or December 31, 2014.

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The following tables summarize the credit risk ratings for commercial, construction, and other non-consumer related loans for June 30, 2015 and December 31, 2014:

June 30, 2015 (in 000's)	Commercial and Industrial	Commercial Real Estate	Real Estate Construction and Development	Agricultural	Total
Grades 1 and 2	$552	$—	$—	$—	$552
Grade 3	7,010	6,046	—	—	13,056
Grades 4 and 5 – pass	47,331	152,844	136,082	33,820	370,077
Grade 6 – special mention	4,957	3,275	—	—	8,232
Grade 7 – substandard	566	1,302	21,445	—	23,313
Grade 8 – doubtful	962	—	—	—	962
Total	$61,378	$163,467	$157,527	$33,820	$416,192

December 31, 2014 (in 000's)	Commercial and Industrial	Commercial Real Estate	Real Estate Construction and Development	Agricultural	Total
Grades 1 and 2	$591	$—	$—	$—	$591
Grade 3	2,012	4,808	775	—	7,595
Grades 4 and 5 – pass	58,179	144,230	114,766	31,600	348,775
Grade 6 – special mention	342	1,095	—	113	1,550
Grade 7 – substandard	1,245	4,539	21,617	—	27,401
Grade 8 – doubtful	—	—	—	—	—
Total	$62,369	$154,672	$137,158	$31,713	$385,912

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, 2015 and December 31, 2014:

	June 30, 2015				December 31, 2014			
(in 000's)	Residential Mortgages	Home Improvement and Home Equity	Installment	Total	Residential Mortgages	Home Improvement and Home Equity	Installment	Total
Not graded	$54,917	$964	$9,171	$65,052	$38,207	$1,038	$10,287	$49,532
Pass	18,088	30	445	18,563	17,887	30	865	18,782
Special Mention	216	—	—	216	216	—	—	216
Substandard	2,626	—	1,100	3,726	2,785	42	650	3,477
Total	$75,847	$994	$10,716	$87,557	$59,095	$1,110	$11,802	$72,007

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):

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

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

Commercial real estate loans – This segment is considered to have more risk in part because of the vulnerability of commercial businesses to economic cycles as well as the exposure to fluctuations in real estate prices because most of these loans are secured by real estate. Losses in this segment have however been historically low because most of the loans are real estate secured, 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, 2015 and 2014 (in 000's).

Six Months Ended June 30, 2015	Commercial and Industrial	Real Estate Mortgage	Real Estate Construction Development	Agricultural	Installment & Other	Commercial Lease Financing	Unallocated	Total
Beginning balance	$1,219	$1,653	$ 6,278	$481	$293	$—	$847	$10,771
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 recoveries	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	1,002	591	146	—	583	—	—	2,322

impairment								
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

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Six Months Ended June 30, 2014	Commercial and Industrial	Real Estate Mortgage	Real Estate Construction Development	Agricultural	Installment & Other	Commercial Lease Financing	Unallocated	Total
Beginning balance	$2,340	$1,862	$ 5,533	$583	$275	$—	$395	$10,988
Recovery of provision for credit losses	(1,026)	(52)	758	(92)	(23)	(46)	341	(140)
Charge-offs	(90)	(131)	(60)	—	—	—	(6)	(287)
Recoveries	172	9	222	3	36	46	—	488
Net charge-offs	82	(122)	162	3	36	46	(6)	201
Ending balance	$1,396	$1,688	$ 6,453	$494	$288	—	$730	$11,049
Period-end amount allocated to:								
Loans individually evaluated for impairment	27	698	—	—	3	—	—	728
Loans collectively evaluated for impairment	1,369	990	6,453	494	285	—	730	10,321
Ending balance	$1,396	$1,688	$ 6,453	$494	$288	—	$730	$11,049

Three Months Ended June 30, 2015	Commercial and Industrial	Real Estate Mortgage	Real Estate Construction Development	Agricultural	Installment & Other	Commercial Lease Financing	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	—	—	(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	1,215	1,018	6,214	450	232	—	101	9,230

evaluated for
impairment