SIERRA BANCORP
Form 10-Q
November 06, 2015

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES

EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2015

Commission file number: 000-33063

Sierra Bancorp

(Exact name of Registrant as specified in its charter)

California	33-0937517
(State of Incorporation)	(IRS Employer Identification No)

86 North Main Street, Porterville, California 93257

(Address of principal executive offices) (Zip Code)

(559) 782-4900

(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 R 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes R No £

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

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

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

Yes £ No R

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, 13,248,048 shares outstanding as of October 30, 2015

FORM 10-Q

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PART I - FINANCIAL INFORMATION

Item 1 – Financial Statements

SIERRA BANCORP

CONSOLIDATED BALANCE SHEETS

(dollars in thousands)

	September 30, 2015 (unaudited)	December 31, 2014 (audited)
ASSETS		
Cash and due from banks	$ 45,658	$ 48,405
Interest-bearing deposits in banks	3,330	1,690
Total cash & cash equivalents	48,988	50,095
Securities available for sale	509,600	511,883
Loans and leases:		
Gross loans and leases	1,054,136	970,653
Allowance for loan and lease losses	(10,412)	(11,248)
Deferred loan and lease fees, net	1,950	1,651
Net loans and leases	1,045,674	961,056
Premises and equipment, net	22,177	21,853
Foreclosed assets	3,003	3,991
Company owned life insurance	43,675	42,989
Goodwill	6,908	6,908
Other intangible assets, net	963	1,064
Other assets	36,146	37,481
	$ 1,717,134	$ 1,637,320
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$ 423,449	$ 390,897
Interest bearing	1,005,665	975,798
Total deposits	1,429,114	1,366,695
Federal funds purchased and repurchase agreements	10,115	7,251
Short-term borrowings	41,500	18,200
Long-term borrowings	2,000	6,000
Junior subordinated debentures	30,928	30,928
Other liabilities	16,425	21,155
Total Liabilities	1,530,082	1,450,229

Commitments and contingent liabilities (Note 8)		
Shareholders' equity		
Common stock, no par value; 24,000,000 shares authorized; 13,248,048 and 13,689,181 shares issued and outstanding at September 30, 2015 and December 31, 2014, respectively	62,324	64,153
Additional paid in capital	2,650	2,605
Retained earnings	118,795	116,026
Accumulated other comprehensive income	3,283	4,307
Total shareholders' equity	187,052	187,091
	$ 1,717,134	$ 1,637,320

The accompanying notes are an integral part of these consolidated financial statements

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SIERRA BANCORP

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share data, unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Interest and dividend income				
Loans and leases, including fees	$ 12,924	$ 11,237	$ 38,124	$ 32,644
Taxable securities	1,847	2,008	6,191	5,709
Tax-exempt securities	746	729	2,202	2,203
Federal funds sold and other	7	4	26	55
Total interest income	15,524	13,978	46,543	40,611
Interest expense				
Deposits	452	503	1,345	1,614
Short-term borrowings	12	6	43	16
Long-term borrowings	2	-	9	-
Subordinated debentures	181	177	533	526
Total interest expense	647	686	1,930	2,156
Net Interest Income	14,877	13,292	44,613	38,455
Provision for loan losses	-	-	-	350
Net interest income after provision for loan losses	14,877	13,292	44,613	38,105
Non-interest income				
Service charges on deposits	2,611	2,214	6,880	6,139
Net gains on sale of securities available-for-sale	108	-	431	287
Other income	1,542	1,571	5,611	5,084
Total non-interest income	4,261	3,785	12,922	11,510
Other operating expense				
Salaries and employee benefits	5,904	5,459	18,924	16,772
Occupancy and equipment	1,834	1,662	5,160	4,700
Other	4,547	4,629	14,412	12,014
Total other operating expense	12,285	11,750	38,496	33,486
Income before taxes	6,853	5,327	19,039	16,129
Provision for income taxes	2,443	1,776	6,335	4,543
Net income	$ 4,410	$ 3,551	$ 12,704	$ 11,586
PER SHARE DATA				
Book value	$ 14.12	$ 13.46	$ 14.12	$ 13.46
Cash dividends	$ 0.11	$ 0.09	$ 0.31	$ 0.25
Earnings per share basic	$ 0.33	$ 0.25	$ 0.94	$ 0.82
Earnings per share diluted	$ 0.33	$ 0.25	$ 0.93	$ 0.81

Average shares outstanding, basic	13,358,895	13,939,152	13,531,370	14,083,649
Average shares outstanding, diluted	13,482,364	14,072,783	13,656,747	14,218,194
Total shareholder equity (in thousands)	$ 187,052	$ 186,240	$ 187,052	$ 186,240
Shares outstanding	13,248,048	13,841,342	13,248,048	13,841,342
Dividends Paid	$ 1,474,639	$ 1,260,823	$ 4,205,218	$ 3,528,478

The accompanying notes are an integral part of these consolidated financial statements

SIERRA BANCORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in thousands, unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Net Income	$ 4,410	$ 3,551	$ 12,704	$ 11,586
Other comprehensive income, before tax:				
Unrealized gains on securities:				
Unrealized holding (losses) gains arising during period	1,284	(237)	(1,225)	5,256
Less: reclassification adjustment for gains [1]	(108)	-	(431)	(287)
Other comprehensive (loss) income, before tax	1,176	(237)	(1,656)	4,969
Income tax expense (benefit) related to items of other comprehensive income (loss), net of tax	(494)	97	632	(2,045)
Other comprehensive income (loss) gain	682	(140)	(1,024)	2,924
Comprehensive Income	$ 5,092	$ 3,411	$ 11,680	$ 14,510

[1] Amounts are included in net gains on investment securities available-for-sale on the Consolidated Statements of Income in non-interest revenue. Income tax expense associated with the reclassification adjustment for the three months ended September 30, 2015 and 2014 was $45 thousand and zero respectively. Income tax expense associated with the reclassification adjustment for the nine months ended September 30, 2015 and 2014 was $181 thousand and $118 thousand respectively.

The accompanying notes are an integral part of these consolidated financial statements

SIERRA BANCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands, unaudited)

	Nine months ended September 30, 2015			2014		
Cash flows from operating activities:						
Net income	$	12,704		$	11,586	
Adjustments to reconcile net income to net cash provided by operating activities:						
Gain on sales of securities		(431	)		(287	)
Gain on sales of loans		(6	)		(3	)
Loss on disposal of fixed assets		62			1	
Gain on sale on foreclosed assets		(166	)		(531	)
Writedowns on foreclosed assets		193			286	
Share-based compensation expense		33			57	
Provision for loan losses		-			350	
Depreciation		1,694			1,569	
Net accretion on purchased loans		(634	)		-	
Net amortization on securities premiums and discounts		5,217			4,925	
Decrease (increase) in unearned net loan fees		299			(16	)
Increase in cash surrender value of life insurance policies		(686	)		(1,001	)
		323			108	

Proceeds from sale of loans				
Increase in loans held-for-sale	(317	)	-	
Decrease in interest receivable and other assets	3,845		1,923	
(Decrease) increase in other liabilites	(4,730	)	1,756	
Deferred Income Tax (Benefit) provision	(1,182	)	864	
Excess tax benefit from equity based compensation	92		-	
Net cash provided by operating activities	16,310		21,587	
Cash flows from investing activities:				
Maturities of securities available for sale	580		995	
Proceeds from sales/calls of securities available for sale	24,408		11,055	
Purchases of securities available for sale	(97,899	)	(111,425	)
Principal pay downs on securities available for sale	68,753		57,062	
Purchases of FHLB stock	(504	)	(190	)
Net increase in loans receivable, net	(84,776	)	(82,126	)
Purchases of premises and equipment, net	(2,136	)	(2,159	)
Proceeds from sale premises and equipment	56		-	
Proceeds from sales of foreclosed assets	1,454		4,421	
Net cash used in investing activities	(90,064	)	(122,367	)
Cash flows from financing activities:				

Increase in deposits		62,419			48,867	
Increase in borrowed funds		19,300			22,390	
Increase in repurchase agreements		2,864			1,196	
Cash dividends paid		(4,205	)		(3,528	)
Repurchases of common stock		(7,956	)		(7,284	)
Stock options exercised		317			811	
Excess tax benefit from equity based compensation		(92	)		-	
Net cash provided by financing activities		72,647			62,452	
Decrease in cash and due from banks		(1,107	)		(38,328	)
Cash and cash equivalents						
Beginning of period		50,095			78,006	
End of period	$	48,988		$	39,678	

The accompanying notes are an integral part of these consolidated financial statements

Sierra Bancorp

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2015

Note 1 – The Business of Sierra Bancorp

Sierra Bancorp (the "Company") is a California corporation headquartered in Porterville, California, and is a registered bank holding company under federal banking laws. The Company was formed to serve as the holding company for Bank of the Sierra (the "Bank"), and has been the Bank's sole shareholder since August 2001. The Company exists primarily for the purpose of holding the stock of the Bank and of such other subsidiaries it may acquire or establish. At the present time, the Company's only other subsidiaries are Sierra Statutory Trust II and Sierra Capital Trust III, which were formed in March 2004 and June 2006, respectively, solely to facilitate the issuance of capital trust pass-through securities ("TRUPS"). Pursuant to the Financial Accounting Standards Board ("FASB") standard on the consolidation of variable interest entities, these trusts are not reflected on a consolidated basis in the Company's financial statements. References herein to the "Company" include Sierra Bancorp and its consolidated subsidiary, the Bank, unless the context indicates otherwise.

The Bank is a California state-chartered bank headquartered in Porterville, California. We offer a full range of retail and commercial banking services primarily in Tulare, Kern, Fresno, and Kings Counties in Central California, and in select markets in Southern California including Ventura County, the Santa Clarita Valley, and the San Fernando Valley. Bank of the Sierra was incorporated in September 1977, and opened for business in January 1978 as a one-branch bank with $1.5 million in capital and eleven employees. Our growth in the ensuing years has primarily been organic, but includes two acquisitions: Sierra National Bank in the year 2000, and Santa Clara Valley Bank ("SCVB") in 2014 (see Note 13 to the financial statements, Recent Developments, for details on the SCVB acquisition). We are now the largest bank headquartered in the South San Joaquin Valley with more than 400 employees, 28 full-service branches, a loan production office and $1.7 billion in assets at September 30, 2015. We have received regulatory approval for another branch in Bakersfield, California which is expected to commence operations in mid-2016, and more recently obtained consent for a branch in Sanger, California which could open in the first quarter of 2016 if approved. In addition to our stand-alone offices the Bank has specialized lending units which include a real estate industries center, an agricultural credit center, and an SBA lending unit. We also operate offsite ATMs at six different non-branch locations. The Bank's deposit accounts are insured by the Federal Deposit Insurance Corporation ("FDIC") up to maximum insurable amounts.

Note 2 – Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in a condensed format, and therefore do not include all of the information and footnotes required by U.S. generally accepted accounting principles ("GAAP") for complete financial statements. The information furnished in these interim statements reflects all adjustments that are, in the opinion of Management, necessary for a fair statement of the results for such period. Such adjustments can generally be considered as normal and recurring unless otherwise disclosed in this Form 10-Q. In preparing the accompanying financial statements, Management has taken subsequent events into consideration and recognized them where appropriate. The results of operations in the interim statements are not necessarily indicative of the results that may be expected for any other quarter, or for the full year. Certain amounts reported for 2014 have been reclassified to be consistent with the reporting for 2015. The interim financial information should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2014, as filed with the Securities and Exchange Commission.

Note 3 – Current Accounting Developments

In January 2014, the FASB issued Accounting Standards Update ("ASU") 2014-01, *Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects*, to provide additional flexibility with regard to accounting for investments in qualified affordable housing projects. ASU 2014-01 modifies the conditions that must be met to present the pretax impact and related tax benefits of such investments as a component of income taxes ("net" within income tax expense), to enable more investors to elect to use a net presentation for those investments. Investors that do not qualify for net presentation under the new guidance will continue to account for such investments under the equity method or cost method, which results in losses recognized in pretax income and tax benefits recognized in income taxes ("gross" presentation of investment results). For investments that qualify for the net presentation of investment performance, ASU 2014-01 introduces a "proportional amortization method" that can be elected to amortize the investment basis. If elected, the method is required for all eligible investments in qualified affordable housing projects. ASU 2014-01 also requires enhanced recurring disclosures for all investments in qualified affordable housing projects, regardless of the accounting method used for those investments. It is effective for interim and annual periods beginning after December 15, 2014. The Company adopted the enhanced disclosure requirements of ASU 2014-01 as of the first quarter of 2015, as reflected in Note 10 to the consolidated financial statements, but we continue to account for our low-income housing tax credit investments using the equity method so there has been no impact on our income statement or balance sheet.

In January 2014, the FASB issued ASU 2014-04, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*, to resolve diversity in practice with respect to a creditor's reclassification of a collateralized consumer mortgage loan to other real estate owned (OREO). Current US GAAP requires a loan to be reclassified to OREO upon a troubled debt restructuring that is "in substance a repossession or foreclosure", where the creditor receives "physical possession" of the debtor's assets regardless of whether formal foreclosure proceedings take place. The terms "in substance a repossession or foreclosure" and "physical possession" are not defined in US GAAP; therefore, questions have arisen about when a creditor should reclassify a collateralized mortgage loan to OREO. ASU 2014-04 requires a creditor to reclassify a collateralized consumer mortgage loan to real estate property upon obtaining legal title to the real estate collateral, or when the borrower voluntarily conveys all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. ASU 2014-04 is effective for public business entities for interim and annual periods beginning after December 15, 2014. It was adopted by the Company for the first quarter of 2015, without any impact on our financial statements or operations.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU is the result of a joint project initiated by the FASB and the International Accounting Standards Board (IASB) to clarify the principles for recognizing revenue, and to develop a common revenue standard and disclosures for U.S. and international accounting standards that would: (1) remove inconsistencies and weaknesses in revenue requirements; (2) provide a more robust framework for addressing revenue issues; (3) improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; (4) provide more useful information to users of financial statements through improved disclosure requirements; and (5) simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. The guidance affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets. The core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides steps to follow to achieve the core principle. An entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative information is required with regard to contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This ASU was originally scheduled to become effective for reporting periods beginning after December 15, 2016. However, subsequent guidance from the FASB issued in August 2015 delayed the effective date by a year, to annual reporting periods beginning after December 15, 2017, including interim periods therein, with early adoption permitted for reporting periods beginning after December 15, 2016. The Company does not expect to adopt this guidance early and is currently evaluating the potential effects of the guidance on its financial statements and disclosures.

In June 2014, the FASB issued ASU 2014-11, *Transfers and Servicing (Topic 860), Repurchase-to-Maturity Transactions,*

Repurchase Financings, and Disclosures. This ASU aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as repurchase financings with the accounting for other more typical repurchase agreements, by requiring that all of these transactions be accounted for as secured borrowings. The guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement, which has resulted in off-balance-sheet accounting. ASU 2014-11 requires a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. It also requires expanded disclosures about the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. ASU 2014-11 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Company has not entered into any repurchase transactions in recent periods, and any such transactions executed by the Company in the future will likely be typical in nature (i.e., not repurchase-to-maturity transactions or repurchase agreements executed as a repurchase financing) and will thus be accounted for as secured borrowings. As such, ASU 2014-11 did not have an impact on the Company’s consolidated financial statements upon adoption, and is not expected to have any impact in future periods.

In June 2014 the FASB issued ASU 2014-12, *Compensation–Stock Compensation (Topic 718)*, which amended existing guidance related to the accounting for share-based payments when the terms of an award provide that a performance target can be achieved after the requisite service period. These amendments require that a performance target be treated as a "performance condition" if it affects vesting and can be achieved after the requisite service period. To account for such awards, a reporting entity should apply existing guidance in Topic 718 as it relates to awards with performance conditions that affect vesting. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest, and should be adjusted to reflect those awards that ultimately vest. The requisite period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. ASU 2014-12 is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. It will be adopted by the Company for the first quarter of 2016, and we do not expect any impact upon our financial statements or operations upon adoption.

In August 2014 the FASB issued ASU 2014-14, *Receivables–Troubled Debt Restructurings by Creditors (Subtopic 310-40), Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure,* which amended existing guidance related to the classification of certain government-guaranteed mortgage loans, including those guaranteed by the FHA and the VA, upon foreclosure. It requires that a mortgage loan be derecognized and a separate "other receivable" be recognized upon foreclosure if the following conditions are met: 1) the loan has a government guarantee that is not separable from the loan before foreclosure; 2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim; and 3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. ASU 2014-14 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. It was adopted by the Company for the first quarter of 2015 with no impact on our financial statements or operations.

In April 2015 the FASB issued ASU 2015-03, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*, to simplify the presentation of debt issuance costs related to a recognized debt liability by reflecting those costs as a direct deduction from the carrying amount of debt liability, consistent with debt discounts. ASU 2015-15 was subsequently issued in August 2015 to clarify the SEC staff's position on presenting and measuring debt issuance costs incurred in connection with line-of-credit arrangements. ASU 2015-03, as modified by ASU 2015-15, is effective for interim and annual periods beginning after December 15, 2015. Early adoption is permitted if the guidance is applied as of the beginning of the annual period of adoption. We do not expect the adoption of this guidance to have a material effect on our consolidated financial statements.

Note 4 – Supplemental Disclosure of Cash Flow Information

During the nine months ended September 30, 2015 and 2014, cash paid for interest due on interest-bearing liabilities was $1.957 million and $2.219 million, respectively. There was $6.390 million in cash paid for income taxes during the nine months ended September 30, 2015, and $160,000 in cash paid for income taxes for the nine months ended September 30, 2014. Assets totaling $1.004 million and $184,000 were acquired in settlement of loans for the nine months ended September 30, 2015 and September 30, 2014, respectively. We received $1.454 million in cash from the sale of foreclosed assets during the first nine months of 2015 relative to $4.421 million during the first nine months of 2014, which represents sales proceeds less loans (if any) extended to finance such sales.

Note 5 – Share Based Compensation

The 2007 Stock Incentive Plan (the "2007 Plan") was adopted by the Company in 2007. Our 1998 Stock Option Plan (the "1998 Plan") was concurrently terminated, although options to purchase 50,200 shares that were granted under the 1998 Plan were still outstanding as of September 30, 2015 and remain unaffected by that plan's termination. The 2007 Plan provides for the issuance of both "incentive" and "nonqualified" stock options to officers and employees, and of "nonqualified" stock options to non-employee directors of the Company. The 2007 Plan also provides for the potential issuance of restricted stock awards to these same classes of eligible participants, on such terms and conditions as are established at the discretion of the Board of Directors or the Compensation Committee. The total number of shares of the Company's authorized but unissued stock reserved for issuance pursuant to awards under the 2007 Plan was initially 1,500,000 shares, although the number remaining available for grant had declined to 785,300 at September 30, 2015. The dilutive impact of stock options outstanding is discussed below in Note 6, Earnings per Share. No restricted stock awards have been issued by the Company.

Pursuant to FASB's standards on stock compensation, the value of each option granted is reflected in our income statement as employee compensation or directors' expense by amortizing the value over the vesting period of such option or by expensing it as of the grant date for immediately vested options. The Company is utilizing the Black-Scholes model to value stock options, and the "multiple option" approach is used to allocate the resulting valuation to actual expense. Under the multiple option approach an employee's options for each vesting period are separately valued and amortized, which appears to be the preferred method for option grants with graded vesting. A pre-tax charge of $14,000 was reflected in the Company's income statement during the third quarter of 2015 and $24,000 was charged during the third quarter of 2014, as expense related to stock options. For the first nine months, the charges totaled $33,000 in 2015 and $57,000 in 2014.

Note 6 – Earnings per Share

The computation of earnings per share, as presented in the Consolidated Statements of Income, is based on the weighted average number of shares outstanding during each period. There were 13,358,895 weighted average shares outstanding during the third quarter of 2015, and 13,939,152 during the third quarter of 2014. There were 13,531,370 weighted average shares outstanding during the first nine months of 2015, and 14,083,649 during the first nine months of 2014.

Diluted earnings per share include the effect of the potential issuance of common shares, which for the Company is limited to shares that would be issued on the exercise of "in-the-money" stock options. The dilutive effect of options outstanding was calculated using the treasury stock method, excluding anti-dilutive shares and adjusting for unamortized expense and windfall tax benefits. For the third quarter and first nine months of 2015 the dilutive effect of options outstanding calculated under the treasury stock method totaled 123,469 and 125,377, respectively, which were added to basic weighted average shares outstanding for purposes of calculating diluted earnings per share. Likewise, for the third quarter and first nine months of 2014 shares totaling 133,631 and 134,545, respectively, were added to basic weighted average shares outstanding in order to calculate diluted earnings per share.

Note 7 – Comprehensive Income

As presented in the Consolidated Statements of Comprehensive Income, comprehensive income includes net income and other comprehensive income. The Company's only source of other comprehensive income is unrealized gains and losses on available-for-sale investment securities. Gains or losses on investment securities that were realized and reflected in net income of the current period, which had previously been included in other comprehensive income as unrealized holding gains or losses in the period in which they arose, are considered to be reclassification adjustments that are excluded from other comprehensive income in the current period.

Note 8 – Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business. Those financial instruments currently consist of unused commitments to extend credit and standby letters of credit. They involve, to varying degrees, elements of risk in excess of the amount recognized in the balance sheet. The Company's exposure to credit loss in the event of nonperformance by counterparties for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and issuing letters of credit as it does for originating loans included on the balance sheet. The following financial instruments represent off-balance-sheet credit risk (dollars in thousands):

	September 30, 2015	December 31, 2014
Commitments to extend credit	$ 370,787	$ 366,909
Standby letters of credit	$ 16,881	$ 14,389

Commitments to extend credit consist primarily of the unused or unfunded portions of the following: home equity lines of credit; commercial real estate construction loans, where disbursements are made over the course of construction; commercial revolving lines of credit; mortgage warehouse lines of credit; unsecured personal lines of credit; and formalized (disclosed) deposit account overdraft lines. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many commitments are expected to expire without being drawn upon, the unused portions of committed amounts do not necessarily represent future cash requirements. Standby letters of credit are generally unsecured and are issued by the Company to guarantee the performance of a customer to a third party, and the credit risk involved in issuing letters of credit is essentially the same as the risk involved in extending loans to customers.

The Company is also utilizing a letter of credit in the amount of $107 million issued by the Federal Home Loan Bank on the Company's behalf as security for certain deposits. That letter of credit is backed by loans which are pledged to the FHLB by the Company.

Note 9 – Fair Value Disclosures and Reporting, the Fair Value Option and Fair Value Measurements

FASB's standards on financial instruments, and on fair value measurements and disclosures, require all entities to disclose in their financial statement footnotes the estimated fair values of financial instruments for which it is practicable to estimate fair values. In addition to disclosure requirements, FASB's standard on investments requires that our debt securities which are classified as available for sale and our equity securities that have readily determinable fair values be measured and reported at fair value in our statement of financial position. Certain impaired loans are also reported at fair value, as explained in greater detail below, and foreclosed assets are carried at the lower of cost or fair value. FASB's standard on financial instruments permits companies to report certain other financial assets and liabilities at fair value, but we have not elected the fair value option for any of those financial instruments.

Fair value measurement and disclosure standards also establish a framework for measuring fair values. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants on the measurement date. Further, the standards establish a fair value hierarchy that encourages an entity to maximize the use of observable inputs and limit the use of unobservable inputs when measuring fair values. The standards describe three levels of inputs that may be used to measure fair values:

- Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

- Level 2: Significant observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

- Level 3: Significant unobservable inputs that reflect a company's own assumptions about the factors that market participants would likely consider in pricing an asset or liability.

Fair value estimates are made at a specific point in time based on relevant market data and information about the financial instruments. The 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 realized gains and losses could have a significant effect on fair value estimates but have not been considered in any estimates. Because no active market exists for a significant portion of our financial instruments, fair value disclosures are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. The estimates are subjective and involve uncertainties and matters of significant judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly alter the fair values presented. The following methods and assumptions were used by the Company to estimate the fair value of its financial instruments disclosed at September 30, 2015 and December 31, 2014:

- Cash and cash equivalents and fed funds sold: The carrying amount is estimated to be fair value.

- Investment securities: Fair values are determined by obtaining quoted prices on nationally recognized securities exchanges or by matrix pricing, which is a mathematical technique used widely in the industry to value debt securities by relying on their relationship to other benchmark quoted securities when quoted prices for specific securities are not readily available.

- Loans and leases: For variable-rate loans and leases that re-price frequently with no significant change in credit risk or interest rate spread, fair values are based on carrying values. Fair values for other loans and leases are estimated by discounting projected cash flows at interest rates being offered at each reporting date for loans and leases with similar terms, to borrowers of comparable creditworthiness. The carrying amount of accrued interest receivable approximates its fair value.

- Loans held for sale: Since loans designated by the Company as available-for-sale are typically sold shortly after making the decision to sell them, realized gains or losses are usually recognized within the same period and fluctuations in fair values are not relevant for reporting purposes. If available-for-sale loans are on our books for an extended period of time, the fair value of those loans is determined using quoted secondary-market prices.

- Collateral-dependent impaired loans: Collateral-dependent impaired loans are carried at fair value when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the original loan agreement and the loan has been written down to the fair value of its underlying collateral, net of expected disposition costs where applicable.

- Cash surrender value of life insurance policies: Fair values are based on net cash surrender values at each reporting date.

- Investments in, and capital commitments to, limited partnerships: The fair values of our limited partner investments in low-income housing tax credit funds and other limited partnership investments are estimated using quarterly indications of value provided by the general partners. The fair values of undisbursed capital commitments are assumed to be the same as their book values.

- Other investments: Certain investments for which no secondary market exists are carried at cost and the carrying amount for those investments typically approximates their estimated fair value, unless an impairment analysis indicates the need for adjustments.

- Deposits: Fair values for non-maturity deposits are equal to the amount payable on demand at the reporting date, which is the carrying amount. Fair values for fixed-rate certificates of deposit are estimated using a cash flow analysis, discounted at interest rates being offered at each reporting date by the Bank for certificates with similar remaining maturities. The carrying amount of accrued interest payable approximates its fair value.

- Short-term borrowings: Current carrying amounts are used as an approximation of fair values for federal funds purchased, overnight advances from the Federal Home Loan Bank ("FHLB"), borrowings under repurchase agreements, and other short-term borrowings maturing within ninety days of the reporting dates. Fair values of other short-term borrowings are estimated by discounting projected cash flows at the Company's current incremental borrowing rates for similar types of borrowing arrangements.

- Long-term borrowings: Fair values are estimated using projected cash flows discounted at the Company's current incremental borrowing rates for similar types of borrowing arrangements.

- Subordinated debentures: Fair values are determined based on the current market value for like instruments of a similar maturity and structure.

- Commitments to extend credit and letters of credit: If funded, the carrying amounts for currently unused commitments would provide an equivalent measure of fair values for the newly created financial assets at the funding date. However, because of the high degree of uncertainty with regard to whether or not those commitments will ultimately be funded, fair values for loan commitments and letters of credit in their current undisbursed state cannot reasonably be estimated, and only notional values are disclosed in the table below.

Estimated fair values for the Company's financial instruments are as follows, as of the dates noted:

Fair Value of Financial Instruments (dollars in thousands, unaudited)	September 30, 2015				
		Estimated Fair Value			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial assets:					
Cash and cash equivalents	$48,988	$48,988	$-	$ -	$48,988
Investment securities available for sale	509,600	1,296	508,304	-	509,600
Loans and leases, net held for investment	1,035,731	-	1,056,516	-	1,056,516
Collateral dependent impaired loans	9,943	-	9,943	-	9,943
Cash surrender value of life insurance policies	43,675	-	43,675	-	43,675
Other investments	7,546	-	7,546	-	7,546
Investment in limited partnership	6,432	-	6,432	-	6,432
Accrued interest receivable	5,662	-	5,662	-	5,662
Financial liabilities:					
Deposits:					
Noninterest-bearing	$423,449	$423,449	$-	$ -	$423,449
Interest-bearing	1,005,665	-	1,005,827	-	1,005,827
Fed funds purchased and repurchase agreements	10,115	-	10,115	-	10,115
Short-term borrowings	41,500	-	41,500	-	41,500
Long-term borrowings	2,000	-	2,004	-	2,004
Subordinated debentures	30,928	-	12,008	-	12,008
Limited partnership capital commitment	795	-	795	-	795
Accrued interest payable	115	-	115	-	115

	Notional Amount
Off-balance-sheet financial instruments:	
Commitments to extend credit	$370,787
Standby letters of credit	16,881

	December 31, 2014				
		Estimated Fair Value			
	Carrying Amount	Quoted Prices in	Significant Observable	Significant Unobservable	Total

		Active Markets for Identical Assets (Level 1)	Inputs (Level 2)	Inputs (Level 3)	
Financial assets:					
Cash and cash equivalents	$50,095	$50,095	$ -	$ -	$50,095
Investment securities available for sale	511,883	2,222	509,661	-	511,883
Loans and leases, net held for investment	956,265	-	966,599	-	966,599
Collateral dependent impaired loans	4,791	-	4,791	-	4,791
Cash surrender value of life insurance policies	42,989	-	42,989	-	42,989
Other Investments	7,042	-	7,042	-	7,042
Investment in limited partnership	7,276	-	7,276	-	7,276
Accrued interest receivable	5,852	-	5,852	-	5,852
Financial liabilities:					
Deposits:					
Noninterest-bearing	$390,897	$390,897	$ -	$ -	$390,897
Interest-bearing	975,798	-	976,002	-	976,002
Fed funds purchased and repurchase agreements	7,251	-	7,251	-	7,251
Short-term borrowings	18,200	-	18,200	-	18,200
Long-term borrowings	6,000	-	6,000	-	6,000
Subordinated debentures	30,928	-	11,428	-	11,428
Limited partnership capital commitment	914	-	914	-	914
Accrued interest payable	137	-	137	-	137

	Notional Amount
Off-balance-sheet financial instruments:	
Commitments to extend credit	$366,909
Standby letters of credit	14,389

For financial asset categories that were actually reported at fair value as of September 30, 2015 and December 31, 2014, the Company used the following methods and significant assumptions:

- Investment securities: Fair values are determined by obtaining quoted prices on nationally recognized securities exchanges or by matrix pricing, which is a mathematical technique used widely in the industry to value debt securities by relying on their relationship to other benchmark quoted securities.

- Collateral-dependent impaired loans: Collateral-dependent impaired loans are carried at fair value when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the original loan agreement and the loan has been written down to the fair value of its underlying collateral, net of expected disposition costs where applicable.

- Foreclosed assets: Repossessed real estate (known as other real estate owned, or "OREO") and other foreclosed assets are carried at the lower of cost or fair value. Fair value is the appraised value less expected selling costs for OREO and some other assets such as mobile homes, and fair values for any other foreclosed assets are represented by estimated sales proceeds as determined using reasonably available sources. Foreclosed assets for which appraisals can be feasibly obtained are periodically measured for impairment using updated appraisals. Fair values for other foreclosed assets are adjusted as necessary, subsequent to a periodic re-evaluation of expected cash flows and the timing of resolution. If impairment is determined to exist, the book value of a foreclosed asset is immediately written down to its estimated impaired value through the income statement, thus the carrying amount is equal to the fair value and there is no valuation allowance.

Assets reported at fair value on a recurring basis are summarized below:

Fair Value Measurements - Recurring

(dollars in thousands, unaudited)

	Fair Value Measurements at September 30, 2015, using				
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Realized Gain/(Loss)
Investment securities					
US Government agencies	$ -	$ 29,741	$ -	$ 29,741	$ -
Mortgage-backed securities	-	377,308	-	377,308	-
State and poltical subdivisions	-	101,255	-	101,255	-
Other securities	1,296	-	-	1,296	-
Total available-for-sale securities	$ 1,296	$ 508,304	$ -	$ 509,600	$ -

	Fair Value Measurements at December 31, 2014, using				
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Realized Gain/(Loss)
Investment securities					
US Government agencies	$ -	$ 27,270	$ -	$ 27,270	$ -
Mortgage-backed securities	-	381,442	-	381,442	-
State and poltical subdivisions	-	100,949	-	100,949	-
Other securities	2,222	-	-	2,222	-
Total available-for-sale securities	$ 2,222	$ 509,661	$ -	$ 511,883	$ -

Assets reported at fair value on a nonrecurring basis are summarized below:

Fair Value Measurements - Nonrecurring

(dollars in thousands, unaudited)

	Fair Value Measurements at September 30, 2015, using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Collateral dependent impaired loans	$ -	$ 9,943	$ -	$ 9,943
Foreclosed assets	$ -	$ 3,003	$ -	$ 3,003

	Fair Value Measurements at December 31, 2014, using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Collateral dependent impaired loans	$ -	$ 4,791	$ -	$ 4,791
Foreclosed assets	$ -	$ 3,991	$ -	$ 3,991

The table above includes collateral-dependent impaired loan balances for which a specific reserve has been established or on which a write-down has been taken. Information on the Company’s total impaired loan balances and specific loss reserves associated with those balances is included in Note 11 below, and in Management’s Discussion and Analysis of Financial Condition and Results of Operation in the “Nonperforming Assets” and “Allowance for Loan and Lease Losses” sections.

The unobservable inputs are based on Management’s best estimates of appropriate discounts in arriving at fair market value. Increases or decreases in any of those inputs could result in a significantly lower or higher fair value measurement. For example, an increase or decrease in actual loss rates would have a directionally opposite change in the calculation of the fair value of unsecured impaired loans.

Note 10 – Investments

Investment Securities

Although the Company currently has the intent and the ability to hold the securities in its investment portfolio to maturity, the securities are all marketable and are classified as “available for sale” to allow maximum flexibility with regard to interest rate risk and liquidity management. Pursuant to FASB’s guidance on accounting for debt and equity securities, available for sale securities are carried on the Company’s financial statements at their estimated fair market values, with monthly tax-effected “mark-to-market” adjustments made vis-à-vis accumulated other comprehensive income in shareholders’ equity.

Amortized Cost And Estimated Fair Value

The amortized cost and estimated fair value of investment securities available-for-sale are as follows

(dollars in thousands, unaudited):

	September 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
US Government agencies	$29,360	$ 389	$ (8)	$ 29,741
Mortgage-backed securities	374,966	3,425	(1,083)	377,308
State and poltical subdivisions	98,951	2,574	(270)	101,255
Other securities	659	637	-	1,296
Total investment securities	$503,936	$ 7,025	$ (1,361)	$ 509,600

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
US Government agencies	$26,959	$ 334	$ (23)	$ 27,270
Mortgage-backed securities	378,339	4,299	(1,196)	381,442
State and political subdivisons	98,056	3,093	(200)	100,949
Other securities	1,210	1,012	-	2,222
Total investment securities	$504,564	$ 8,738	$ (1,419)	$ 511,883

At September 30, 2015 and December 31, 2014, the Company had 167 securities and 134 securities, respectively, with unrealized losses. Management has evaluated those securities as of the respective dates, and does not believe that any of the associated unrealized losses are other than temporary. Gross unrealized losses on our investment securities as of the indicated dates are disclosed in the table below, categorized by investment type and by the duration of time that loss positions on individual securities have continuously existed (over or under twelve months).

Investment Portfolio - Unrealized Losses

(dollars in thousands, unaudited)	September 30, 2015			
	Less than twelve months		Twelve months or more	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
US Government agencies	$(8)	$1,719	$ -	$ -
Mortgage-backed securities	(735)	121,574	(348)	36,331
State and political subdivisions	(162)	18,004	(108)	5,081
Total	$(905)	$141,297	$ (456)	$ 41,412

	December 31, 2014			
	Less than twelve months		Twelve months or more	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
US Government agencies	$(23)	$ 3,485	$ -	$ -
Mortgage-backed securities	(564)	84,004	(632)	51,982
State and political subdivisions	(31)	7,738	(169)	9,045
Total	$(618)	$ 95,227	$ (801)	$ 61,027

The table below summarizes the Company’s gross realized gains and losses as well as gross proceeds from the sales of securities, for the periods indicated:

Investment Portfolio - Realized Gains/(Losses)

(dollars in thousands, unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Proceeds from sales, calls and maturities of securities available	$ 198	$ -	$ 24,988	$ 12,050

for sale				
Gross gains on sales, calls and maturities of securities available for sale	$ 108	$ -	$ 630	$ 289
Gross losses on sales, calls and maturities of securities available for sale	-	-	(199)	(2)
Net gains on sale of securities available for sale	$ 108	$ -	$ 431	$ 287

The amortized cost and estimated fair value of investment securities available-for-sale at September 30, 2015 and December 31, 2014 are shown below, grouped by the remaining time to contractual maturity dates. The expected life of investment securities may not be consistent with contractual maturity dates, since the issuers of the securities could have the right to call or prepay obligations with or without penalties.

Estimated Fair Value of Contractual Maturities

(dollars in thousands, unaudited)	September 30, 2015	
	Amortized Cost	Fair Value
Maturing within one year	$4,119	$4,160
Maturing after one year through five years	244,792	247,764
Maturing after five years through ten years	58,634	59,743
Maturing after ten years	50,736	51,444
Investment securities not due at a single maturity date:		
U.S Government agencies collateralized by mortgage obligations	144,996	145,193
Other securities	659	1,296
	$503,936	$509,600

	December 31, 2014	
	Amortized Cost	Fair Value
Maturing within one year	$686	$694
Maturing after one year through five years	222,081	225,415
Maturing after five years through ten years	97,949	99,583
Maturing after ten years	54,531	55,705
Investment securities not due at a single maturity date:		
U.S Government agencies collateralized by mortgage obligations	128,107	128,264
Other securities	1,210	2,222
	$504,564	$511,883

At September 30, 2015, the Company’s investment portfolio included securities issued by 279 different government municipalities and agencies located within 27 states with a fair value of $101.3 million. The largest exposure to any single municipality or agency was a $1.1 million (fair value) refunding bond issued by the Columbia River People’s Utility District, to be repaid by future utility revenue.

The Company’s investments in bonds issued by states, municipalities and political subdivisions are evaluated in accordance with Supervision and Regulation Letter 12-15 issued by the Board of Governors of the Federal Reserve System, “Investing in Securities without Reliance on Nationally Recognized Statistical Rating Organization Ratings,” and other regulatory guidance. Credit ratings are considered in our analysis only as a guide to the historical default rate associated with similarly-rated bonds. There have been no significant differences in our internal analyses compared with the ratings assigned by the third party credit rating agencies.

The following table summarizes the amortized cost and fair values of general obligation and revenue bonds in the Company's investment securities portfolio at the indicated dates, identifying the state in which the issuing municipality or agency operates for our largest geographic concentrations:

Revenue and General Obligation Bonds by Location dollars in thousands, unaudited	September 30, 2015		December 31, 2014	
	Amortized Cost	Fair Market Value	Amortized Cost	Fair Market Value
General obligation bonds				
State of issuance				
California	$20,023	$ 21,110	$20,078	$ 21,288
Texas	14,718	14,908	14,489	14,675
Illinois	10,014	10,089	8,272	8,394
Ohio	8,254	8,317	7,456	7,555
Washington	5,920	6,067	5,966	6,126
Utah	954	976	956	984
Other states	22,618	23,036	21,253	21,832
Total General Obligation Bonds	82,501	84,503	78,470	80,854
Revenue bonds				
State of issuance				
Utah	4,437	4,469	3,769	3,834
Texas	3,744	3,845	3,273	3,387
California	1,003	1,031	2,174	2,233
Washington	1,370	1,389	1,167	1,197
Ohio	319	321	321	332
Illinois	292	293	294	294
Other states	5,285	5,404	8,588	8,818
Total Revenue Bonds	16,450	16,752	19,586	20,095
Total Obligations of States and Political Subdivisions	$98,951	$ 101,255	$98,056	$ 100,949

The revenue bonds in the Company's investment securities portfolios were issued by government municipalities and agencies to fund public services such as utilities (water, sewer, and power), educational facilities, and general public and economic improvements. The primary sources of revenue for these bonds are delineated in the table below, which shows the amortized cost and fair market values for the largest revenue concentrations as of the indicated dates.

Revenue Bonds by Type

dollars in thousands, unaudited	September 30, 2015		December 31, 2014	
	Amortized Cost	Fair Market Value	Amortized Cost	Fair Market Value
Revenue bonds				
Revenue source:				
Water	$ 3,653	$ 3,712	$ 7,100	$ 7,278
College & University	3,201	3,300	2,723	2,834
Sales Tax	2,292	2,328	2,361	2,405
Lease	2,198	2,199	1,356	1,362
Electric & Power	1,874	1,884	1,880	1,914
Other sources	3,232	3,329	4,166	4,302
Total Revenue Bonds	$ 16,450	$ 16,752	$ 19,586	$ 20,095

Low-Income Housing Tax Credit ("LIHTC") Fund Investments

The Company has the ability to invest in limited partnerships which own housing projects that qualify for federal and/or California state tax credits, by mandating a specified percentage of low-income tenants for each project. The tax credits flow through to investors, augmenting any returns that might be derived from an increase in property values. Because rent levels are lower than standard market rents and the projects are generally highly leveraged, each project also typically generates tax-deductible operating losses that are allocated to the limited partners.

The Company invested in seven such LIHTC fund limited partnerships from 2001 through 2007, and may make similar investments in the future. Our investments to date have all been in California-focused funds, which helps the Company meet its obligations under the Community Reinvestment Act. We utilize the equity method of accounting for our LIHTC fund investments. Under the equity method, our balance sheet initially reflects an asset that represents the total cash expected to be invested over the life of the partnership. Any commitments or contingent commitments for future investment are reflected as a liability. The income statement treatment under the equity method reflects tax credits received by the Company "below the line" within the income tax provision, while any fund operating results are included "above the line" in non-interest income. As noted above, operating results are typically losses that are netted against non-interest income.

As of September 30, 2015 our total remaining LIHTC investment balance was $5.1 million, and we had no commitments or contingent commitments for additional capital contributions to the limited partnerships. There were $578,000 in tax credits derived from our LIHTC investments which were recognized during the nine months ended September 30, 2015, and a pass-through operating loss of $844,000 associated with those investments was included in pre-tax income for the same time period. Our LIHTC investments are evaluated annually for potential impairment, and we have concluded that the carrying value of the investments is fairly stated and is not impaired.

Note 11 – Credit Quality and Nonperforming Assets

Credit Quality Classifications

The Company monitors the credit quality of loans on a continuous basis using the regulatory and accounting classifications of pass, special mention, substandard and impaired to characterize the associated credit risk. Balances classified as “loss” are immediately charged off. The Company conforms to the following definitions for risk classifications utilized:

- Pass: Larger non-homogeneous loans not meeting the risk rating definitions below, and smaller homogeneous loans that are not assessed on an individual basis.

- Special mention: Loans which have potential issues that deserve the close attention of Management. If left uncorrected, those potential weaknesses could eventually diminish the prospects for full repayment of principal and interest according to the contractual terms of the loan agreement, or could result in deterioration of the Company's credit position at some future date.

- Substandard: Loans that have at least one clear and well-defined weakness that could jeopardize the ultimate recoverability of all principal and interest, such as a borrower displaying a highly leveraged position, unfavorable financial operating results and/or trends, uncertain repayment sources or a deteriorated financial condition.

- Impaired: 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 according to the contractual terms of the loan agreement. Impaired loans include all nonperforming loans, restructured troubled debt ("TDRs"), and certain other loans that are still being maintained on accrual status. A TDR may be nonperforming or performing, depending on its accrual status and the demonstrated ability of the borrower to comply with restructured terms (see "Troubled Debt Restructurings" section below for additional information on TDRs).

Credit quality classifications for the Company’s loan balances were as follows, as of the dates indicated:

Credit Quality Classifications
(dollars in thousands, unaudited)

	September 30, 2015				
	Pass	Special Mention	Substandard	Impaired	Total
Real Estate:					
1-4 family residential construction	$8,146	$374	$ -	$-	$8,520
Other construction/land	31,396	185	-	1,044	32,625
1-4 family - closed end	126,900	686	403	6,487	134,476
Equity lines	40,952	281	1,563	2,034	44,830
Multi-family residential	26,299	-	626	416	27,341
Commercial real estate - owner occupied	191,431	14,265	7,777	3,284	216,757
Commercial real estate - non-owner occupied	141,936	6,795	172	11,941	160,844
Farmland	121,292	4,206	730	47	126,275
Total real estate	688,352	26,792	11,271	25,253	751,668
Agricultural	36,377	373	70	-	36,820
Commercial and industrial	102,635	1,042	571	2,695	106,943
Mortgage Warehouse	142,608	-	-	-	142,608
Consumer loans	13,544	268	17	2,268	16,097
Total gross loans and leases	$983,516	$28,475	$ 11,929	$30,216	$1,054,136

	December 31, 2014				
	Pass	Special Mention	Substandard	Impaired	Total
Real Estate:					
1-4 family residential construction	$5,858	$-	$ -	$-	$5,858
Other construction/land	15,238	247	-	4,423	19,908
1-4 family - closed end	105,398	833	918	7,110	114,259
Equity lines	46,819	294	1,237	1,367	49,717
Multi-family residential	18,127	420	-	171	18,718
Commercial real estate - owner occupied	191,495	18,694	3,845	4,620	218,654
Commercial real estate - non-owner occupied	114,317	4,250	631	12,879	132,077
Farmland	142,295	1,950	744	50	145,039
Total real estate	639,547	26,688	7,375	30,620	704,230
Agricultural	27,215	531	-	-	27,746
Commercial and industrial	108,469	1,529	857	2,916	113,771
Mortgage Warehouse	106,021	-	-	-	106,021
Consumer loans	15,752	222	23	2,888	18,885
Total gross loans and leases	$897,004	$28,970	$ 8,255	$36,424	$970,653

Past Due and Nonperforming Assets

Nonperforming assets are comprised of loans for which the Company is no longer accruing interest, and foreclosed assets, including mobile homes and OREO. OREO consists of properties acquired by foreclosure or similar means, which the Company is offering or will offer for sale. Nonperforming loans and leases result when reasonable doubt surfaces with regard to the ability of the Company to collect all principal and interest. At that point, we stop accruing interest on the loan or lease in question and reverse any previously-recognized interest to the extent that it is uncollected or associated with interest-reserve loans. Any asset for which principal or interest has been in default for 90 days or more is also placed on non-accrual status even if interest is still being received, unless the asset is both well secured and in the process of collection. An aging of the Company's loan balances is presented in the following tables, by number of days past due as of the indicated dates:

Loan Portfolio Aging
(dollars in thousands, unaudited)

	September 30, 2015			
	30-59 Days Past Due	60-89 Days Past Due	90 Days Or More Past Due[1]	Total Past Due