SADLIER R DANIEL
Form 4
December 04, 2012

FORM 4

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL	
OMB Number:	3235-0287
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

(Print or Type Responses)

1. Name and Address of Reporting Person *
SADLIER R DANIEL

(Last) (First) (Middle)

ONE VECTREN SQUARE, P. O. BOX 209

(Street)

EVANSVILLE, IN 47708

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
VECTREN CORP [VVC]

3. Date of Earliest Transaction (Month/Day/Year)
12/03/2012

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security	2. Conversion or Exercise	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any	4. Transaction Code	5. Number of Derivative Securities	6. Date Exercisable and Expiration Date (Month/Day/Year)	7. Title and Amount of Underlying Securities (Instr. 3 and 4)

(Instr. 3)	Price of Derivative Security	(Month/Day/Year)	(Instr. 8)		Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)					
			Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares
Phantom Stock	$ 0	12/03/2012	J(1)		560.1269		(2)	(2)	Common Stock	560.1269

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
SADLIER R DANIEL ONE VECTREN SQUARE P. O. BOX 209 EVANSVILLE, IN 47708	X			

Signatures

/s/Ronald E. Christian	12/04/2012
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Exempt acquisition of phantom shares acquired through the Vectren Corporation ("Vectren") Nonqualified Deferred Compensation Plan ("Plan"). These transactions are exempt under Rule 16b-3.

(2) Phantom stock units held under the non-qualified deferred compensation plan will effectively be exercised at the time the amounts represented by those units are paid out under the Plan. Generally, unless provided otherwise by the participant, the payout begins with the end of the board member's service as a member of the board. Pursuant to the non-qualified deferred compensation plan, payouts can occur for up to 15 years. Amounts held in the phantom stock accounts would be amortized over that period unless directed otherwise by the participant.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
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99.1
Press release re Internet Gold Reports Third Quarter 2011 Financial Results dated November 10, 2011.

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n: right">89,604 420 0.47%Certificates of
Deposit≥$100,000 215,625 535 0.25% 202,196 691 0.34% 211,541 823 0.39%Brokered
Deposits 644 11 1.71% 5,940 94 1.58% 11,233 157 1.40%Total Interest Bearing
Deposits 1,014,443 1,785 0.18% 881,066 2,064 0.23% 809,967 2,455 0.30%Borrowed

Funds: Federal Funds Purchased 6 - - 12 - - 2 - - Repurchase
Agreements 8,601 35 0.41% 5,936 21 0.35% 2,876 13 0.45%Short Term
Borrowings 14,697 31 0.21% 3,502 4 0.11% 3,497 6 0.17%Long Term
Borrowings 2,504 13 0.52% 904 4 0.44% 1,041 33 3.17%TRUPS 30,928 717 2.32% 30,928 703 2.27% 30,928
Borrowed Funds 56,736 796 1.40% 41,282 732 1.77% 38,344 766 2.00%Total Interest Bearing
Liabilities 1,071,179 2,581 0.24% 922,348 2,796 0.30% 848,311 3,221 0.38%Non-interest Bearing Demand
Deposits 417,993 355,395 348,579 Other
Liabilities 15,116 17,213 16,184 Shareholders'
Equity 188,481 186,393 176,779 Total Liabilities and Shareholders'
Equity $1,692,769 $1,481,349 $1,389,853 Interest Income/Interest Earning
Assets 4.16% 4.22% 4.28%Interest Expense/Interest Earning
Assets 0.17% 0.21% 0.26%**Net Interest Income and**
Margin(5) $60,126 3.99% $52,325 4.01% $48,564 4.02%

(1) Average balances are obtained from the best available daily or monthly data and are net of deferred fees and related direct costs.

(2) Yields and net interest margin have been computed on a tax equivalent basis.

(3) Loans are gross of the allowance for possible loan losses. Net loan fees have been included in the calculation of interest income. Net loan Fees and loan acquisition FMV amortization were $276,596, $(731,316) and $(10,967) for the years ended December 31, 2015, 2014, and 2013 respectively.

(4) Non-accrual loans are slotted by loan type and have been included in total loans for purposes of total interest earning assets.

(5) Net interest margin represents net interest income as a percentage of average interest-earning assets (tax-equivalent).

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The Volume and Rate Variances table below sets forth the dollar difference for the comparative periods in interest earned or paid for each major category of interest-earning assets and interest-bearing liabilities, and the amount of such change attributable to fluctuations in average balances (volume) or differences in average interest rates. Volume variances are equal to the increase or decrease in average balances multiplied by prior period rates, and rate variances are equal to the change in rates multiplied by prior period average balances. Variances attributable to both rate and volume changes, calculated by multiplying the change in rates by the change in average balances, have been allocated to the rate variance.

Volume & Rate Variances	Years Ended December 31,					
(dollars in thousands)	2015 over 2014			2014 over 2013		
	Increase(decrease) due to			Increase(decrease) due to		
	Volume	Rate	Net	Volume	Rate	Net
Assets:						
Investments:						
Federal funds sold / Due from time	$(33)	$2	$(31)	$(40)	$-	$(40)
Taxable	985	(446)	539	786	1,968	2,754
Non-taxable[(1)]	65	(48)	17	355	(156)	199
Equity	(26)	(45)	(71)	2	71	73
Total Investments	991	(537)	454	1,103	1,883	2,986
Loans and Leases:						
Real Estate	5,233	(554)	4,679	4,175	(1,715)	2,460
Agricultural	274	62	336	(20)	2	(18)
Commercial	291	169	460	23	(601)	(578)
Consumer	(378)	162	(216)	(395)	197	(198)
Mortgage Warehouse	2,441	(610)	1,831	(678)	(668)	(1,346)
Direct Financing Leases	(24)	(3)	(27)	(35)	3	(32)
Other	169	(100)	69	-	62	62
Total Loans and Leases	8,006	(874)	7,132	3,070	(2,720)	350
Total Interest Earning Assets	$8,997	$(1,411)	$7,586	$4,173	$(837)	$3,336
Liabilities						
Interest Bearing Deposits:						
Demand						
NOW	$42	$30	$72	$71	$(69)	$2
Savings Accounts	68	(62)	6	89	(110)	(21)
Money Market	51	(85)	(34)	44	(88)	(44)
CDAR's	29	(31)	(2)	12	(26)	(14)
Certificates of Deposit < $100,000	(1)	(2)	(3)	(3)	(22)	(25)
Certificates of Deposit ≥ $100,000	(2)	(77)	(79)	(56)	(38)	(94)
Brokered Deposits	46	(202)	(156)	(36)	(96)	(132)
Total Interest Bearing Deposits	(84)	1	(83)	(74)	11	(63)
Borrowed Funds:	149	(428)	(279)	47	(438)	(391)
Federal Funds Purchased	-	-	-	-	-	-
Repurchase Agreements	9	5	14	14	(6)	8

Short Term Borrowings	13	14	27	-	(2)	(2)
Long Term Borrowings	7	2	9	(4)	(25)	(29)
TRUPS	-	14	14	-	(11)	(11)
Total Borrowed Funds	29	35	64	10	(44)	(34)
Total Interest Bearing Liabilities	178	(393)	(215)	57	(482)	(425)
Net Interest Income	$8,819	$(1,018)	$7,801	$4,116	$(355)	$3,761

(1) Yields on tax exempt income have not been computed on a tax equivalent basis.

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The volume variance calculated for 2015 over 2014 was a favorable $8.819 million, due primarily to a $203 million increase in the average balance of interest-earning assets resulting from our acquisition of Santa Clara Valley Bank, organic growth, and loan purchases. The volume variance was enhanced by the fact that the average balance of loans grew by 20% relative to only 7% growth in the average balance of lower-yielding investments, as well as a shift within investments out of lower-yielding balances held at the Federal Reserve Bank. It was unfavorably impacted by the fact that lower-yielding mortgage warehouse loans and agricultural loans experienced disproportionate growth relative to other loan categories.

The impact of interest rate changes resulted in an unfavorable rate variance of $1.018 million in net interest income for 2015 relative to 2014. Despite the fact that our yield on earning assets and cost of interest-bearing liabilities were both down by six basis points, the rate variance was negative due to the volume differential between our interest-earning assets and interest-bearing liabilities. That differential averaged $422 million for 2014, the base period for the rate variance calculation, thus the decrease in our earning asset yield was applied to a much higher balance than the rate decrease for interest-bearing liabilities and had a greater impact on net interest income. Investment yields were lower due to the reinvestment of portfolio cash flows in a historically low interest rate environment, and the weighted average yield on loans declined due to the impact of continued competition on loan rates and relatively robust growth in lower-yielding mortgage warehouse loans. Our weighted average cost of interest-bearing liabilities was down because of a drop in deposit rates, combined with a lower overall rate on non-deposit borrowings resulting from disproportionate growth in low-cost short-term borrowings.

The Company’s net interest margin, which is tax-equivalent net interest income as a percentage of average interest-earning assets, is affected by the same factors discussed above relative to rate and volume variances. Our net interest margin was 3.99% in 2015, a drop of only 2 basis points relative to 2014. The principal developments impacting our net interest margin in 2015 include lower yields on loans and investments, and a shift within loans to lower-yielding loan segments. Partially alleviating the negative pressures on loan rates was higher non-recurring interest income such as net interest recovered on non-accrual loans and prepayment penalties, which totaled $825,000 in 2015 relative to $505,000 in 2014. Lower deposit rates also helped offset the negative factors impacting our net interest margin.

Provision for Loan and Lease Losses

Credit risk is inherent in the business of making loans. The Company sets aside an allowance for loan and lease losses, a contra-asset account, through periodic charges to earnings which are reflected in the income statement as the provision for loan and lease losses. A loan loss provision was not required for 2015, but we recorded a loan loss provision of $350,000 in 2014.

The Company's loan loss provision has been sufficient to maintain our allowance for loan and lease losses at a level that, in Management's judgment, is adequate to absorb probable loan losses related to specifically-identified impaired loans as well as probable incurred losses in the remaining loan portfolio. Specifically identifiable and quantifiable loan losses are immediately charged off against the allowance. Net loans charged off by the Company totaled $825,000 in 2015 relative to $779,000 in 2014, but those charge-offs were primarily recorded against reserves established in previous periods and thus did not necessitate reserve replenishment. Additional factors impacting our allowance for loan and lease losses and lack of provisioning in recent periods include the following: loan growth has occurred in portfolio segments with low historical loss rates, and credit quality improvement is evident in the remainder of the loan portfolio due to tighter loan underwriting standards implemented subsequent to the recession.

The Company's policies for monitoring the adequacy of the allowance and determining loan amounts that should be charged off, and other detailed information with regard to changes in the allowance, are discussed below under "Allowance for Loan and Lease Losses." The process utilized to establish an appropriate allowance for loan and lease losses can result in a high degree of variability in the Company's loan loss provision, and consequently in our net earnings.

Non-interest Revenue and Operating Expense

The table below sets forth the major components of the Company's non-interest revenue and operating expense, along with relevant ratios, for the years indicated:

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Non-Interest Income/Expense

(dollars in thousands)

	Year Ended December 31,								
	2015	% of Total		2014	% of Total		2013	% of Total	
NON-INTEREST INCOME:									
Service charges on deposit accounts	$9,399	53.06	%	$8,275	52.27	%	$9,022	52.87	%
Credit card fees	463	2.61	%	451	2.85	%	462	2.71	%
Checkcard fees	4,234	23.90	%	3,908	24.69	%	3,749	21.97	%
Other service charges and fees	3,154	17.80	%	2,336	14.76	%	2,372	13.90	%
Bank owned life insurance income	907	5.12	%	1,278	8.07	%	1,787	10.47	%
Gains on sale of loans	6	0.03	%	3	0.02	%	129	0.76	%
Gain on sales securities	666	3.76	%	667	4.21	%	6	0.04	%
(Loss) on tax credit investment	(1,058)	-5.97	%	(1,161)	-7.33	%	(1,063)	-6.23	%
Other	(56)	-0.31	%	74	0.46	%	599	3.51	%
Total non-interest income	17,715	100.00	%	15,831	100.00	%	17,063	100.00	%
As a % of average interest-earning assets		1.15	%		1.18	%		1.37	%
OTHER OPERATING EXPENSES:									
Salaries and employee benefits	24,871	49.05	%	22,926	49.44	%	21,920	48.91	%
Occupancy costs									
Furniture and equipment	2,060	4.06	%	1,862	4.02	%	1,964	4.38	%
Premises	4,839	9.54	%	4,482	9.66	%	4,310	9.62	%
Advertising and promotion costs	2,319	4.57	%	2,205	4.75	%	1,960	4.37	%
Data processing costs	3,426	6.76	%	2,716	5.86	%	1,562	3.49	%
Deposit services costs	3,182	6.28	%	2,587	5.58	%	2,405	5.37	%
Loan services costs									
Loan processing	891	1.76	%	1,113	2.40	%	999	2.23	%
Foreclosed Assets	153	0.30	%	(1,420)	-3.06	%	1,529	3.41	%
Other operating costs									
Telephone and data communications	1,857	3.66	%	1,283	2.77	%	1,613	3.60	%
Postage and mail	923	1.82	%	775	1.67	%	713	1.59	%
Other	800	1.58	%	716	1.54	%	682	1.51	%
Professional services costs									
Legal and accounting	1,337	2.64	%	1,244	2.68	%	1,688	3.77	%
Acquisition costs	101	0.20	%	2,070	4.46	%	-	-	
Other professional services costs	1,785	3.52	%	2,110	4.55	%	2,455	5.48	%
Stationery and supply costs	1,296	2.56	%	1,192	2.57	%	657	1.47	%
Sundry & tellers	863	1.70	%	514	1.11	%	358	0.80	%
Total other operating expense	$50,703	100.00	%	$46,375	100.00	%	$44,815	100.00	%
As a % of average interest-earning assets		3.28	%		3.45	%		3.60	%
Net non-interest income as a % of average interest-earning assets		-2.13	%		-2.27	%		-2.23	%

Efficiency ratio [1]	63.98 %	66.48 %	65.95 %

[1] Tax Equivalent

The Company's results reflect an increase in total non-interest income $1.884 million, or 12%, in 2015 over 2014, but a decline of $1.232 million, or 7%, in 2014 relative to 2013. While the primary reasons for the changes in non-interest income are discussed in greater detail below, several items of a nonrecurring nature have had a significant impact over the past few years. In 2015, non-recurring non-interest income was comprised of $666,000 in gains on the sale of investments and $245,000 in special dividends received pursuant to our equity investment in the Federal Home Loan Bank ("FHLB"). In 2014, non-recurring income consisted primarily of $667,000 in gains on the sale of investments. For 2013, non-recurring income items include $397,000 in life insurance proceeds and a $100,000 non-recurring signing incentive received in conjunction with our merchant processing vendor conversion. Total non-interest income was 1.15% of average interest-earning assets in 2015, relative to 1.18% in 2014 and 1.37% in 2013. The lower ratio in 2015 is primarily due to a higher average balance of interest-earning assets.

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The principal component of the Company’s non-interest revenue, namely service charges on deposit accounts, increased by $1.124 million, or 14%, in 2015 relative to 2014 due primarily to fees earned from increased activity in commercial accounts and higher overdraft income in 2015, and from a decline in fee income in 2014 resulting from certain non-recurring fee waivers made in the course of our core software conversion. Deposit service charges fell by $747,000, or 8%, in 2014 relative to 2013, due mainly to lower fees received from customer overdrafts and returned items, but certain other service charges were also down due to the aforementioned fee waivers. The Company’s ratio of service charge income to average transaction account balances was 1.1% in 2015, down from 1.2% in 2014 and 1.4% in 2013.

The line item immediately following service charges on deposits is credit card fees, comprised primarily of credit card interchange income. Despite the sale of all credit card balances in 2007, we still receive a portion of the interchange and interest income from credit cards issued in our name by a third party vendor. Credit card fees did not change materially in 2015 relative to the prior two years. Checkcard fees, which consist of interchange fees from our customers’ use of debit cards for electronic funds transactions, increased by $326,000, or 8%, in 2015 over 2014, and by $159,000, or 4%, in 2014 over 2013. The increases can be explained primarily by growth in our deposit account base, including the addition of accounts pursuant to our acquisition of SCVB.

Other service charges and fees also constitute a relatively large portion of non-interest income, with the principal components consisting of ATM fees from transactions not associated with deposit customers (also referred to as foreign ATM fees), dividends on restricted stock, check printing fees, currency order fees, and other fees for merchant services. This category increased by $818,000, or 35%, in 2015 over 2014, with the increase comprised of a $481,000 increase in dividends on restricted stock, including the aforementioned nonrecurring special dividend from the FHLB, and increases in other activity-based fees. For 2014 relative to 2013, other service charges and fees dropped by $36,000, or 2%. Fees on merchant accounts declined in 2014, reflecting the impact of a $100,000 non-recurring incentive received in conjunction with our conversion to a new merchant processing vendor in the first quarter of 2013, but that drop was largely offset by increases in other areas, including dividends received on restricted stock.

Bank-owned life insurance (“BOLI”) income was down $371,000, or 29%, in 2015 relative to 2014, and also dropped by $509,000 for 2014 over 2013 due mainly to fluctuations in BOLI income associated with deferred compensation plans. The Company owns and derives income from two basic types of BOLI: “general account” and “separate account.” At December 31, 2015 the Company had $39.3 million invested in single-premium general account BOLI, which generates income that is used to fund expenses associated with executive salary continuation plans, director retirement plans and other employee benefits. Interest credit rates on general account BOLI do not change frequently and the income is typically fairly consistent, but rate reductions have led to slightly lower income levels in recent periods. In addition to general account BOLI the Company had $4.9 million invested in separate account BOLI at December 31, 2015, which produces income that helps offset deferred compensation accruals for certain directors and senior officers. These deferred compensation BOLI accounts have returns pegged to participant-directed investment allocations that can include equity, bond, or real estate indices, and are thus subject to gains or losses which often contribute to significant fluctuations in income (and associated expense accruals). There was a loss on separate account BOLI totaling $65,000 in 2015 relative to a gain of $315,000 in 2014, for a year over year drop of $380,000 in deferred compensation BOLI income. There was also a gain on separate account BOLI of $770,000 in 2013, thus

2014 over 2013 reflects a decline of $455,000 in deferred compensation BOLI income. As noted, gains and losses on separate account BOLI are related to expense accruals or reversals associated with participant gains and losses on deferred compensation balances, thus their impact on taxable income tends to be neutral.

Gains on the sale of loans dropped to immaterial levels in 2015 and 2014 since the Company has been retaining almost all of the loans it originates. We did, however, realize $666,000 in gains on the sale of investments in 2015, almost the same as the $667,000 in gains realized in 2014 but up materially from only $6,000 in gains for 2013. The next line item reflects pass-through losses associated with our investments in low-income housing tax credit funds and other limited partnership investments. Those costs, which are netted out of revenue, dropped by $103,000, or 9%, in 2015 over 2014, but increased by $98,000, or 9%, in 2014 over 2013.

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Other non-interest income includes gains and losses on the disposition of assets other than OREO, rent on bank-owned property other than OREO, life insurance proceeds, and other miscellaneous income. Other non-interest income was down $130,000 in 2015 relative to 2014, and declined $525,000 in 2014 relative to 2013. Income generated through the Company's alliance with Investment Centers of America ("ICA") has been included in this line item, but the Company terminated its affiliation with ICA effective July 31, 2014 thus related income was down $68,000 in 2015. Certain expenses associated with our ICA relationship have also been eliminated, however, and the net financial impact on the Company is not material. The drop in other non-interest income in 2015 also includes the disposition of certain fixed assets at a $62,000 loss. The decline in this category in 2014 includes a $52,000 drop in ICA income, a $71,000 reduction in gains on the disposition of equipment and other fixed assets resulting from gains in 2013, and a $397,000 reduction in life insurance proceeds due to insurance income received in 2013.

Total operating expense, or non-interest expense, increased by $4.328 million, or 9%, in 2015 over 2014, and by $1.560 million, or 3%, in 2014 relative to 2013. The increase in 2015 is comprised in large part of ongoing operating costs incidental to our November 2014 acquisition and February 2014 core banking system conversion, debit card losses, and higher net expenses associated with foreclosed assets. The increase for 2014 is centered in non-recurring acquisition costs, expenses associated with our core system conversion, and compensation costs, partially offset by substantial gains on the sale of foreclosed assets. Non-interest expense includes the following items of a non-recurring nature: for 2015, net OREO expense of $153,000 and one-time acquisition costs totaling $101,000; for 2014, acquisition costs of $2.070 million, certain marketing expenses related to our acquisition and a rebranding initiative, a net OREO expense reversal of $1.420 million due to gains on the sale of OREO, commissions totaling $290,000 paid with regard to the sale of certain nonperforming loans, and credits totaling $155,000 for incorrect telecommunications billings in prior periods; and, for 2013, net OREO expense of $1.529 million. Non-interest expense declined to 3.28% of average earning assets for 2015 from 3.45% in 2014 and 3.60% in 2013, due to a sizeable increase in the denominator.

The largest component of operating expense, namely salaries and employee benefits, was up $1.945 million, or 8%, in 2015 over 2014, and increased by $1.006 million, or 5%, in 2014 over 2013. The increase for 2015 is due primarily to personnel increases associated with our acquisition, regular annual salary increases, higher group health insurance premiums, and an increased accrual for Company contributions to the employee 401(k) retirement plan. Those increases were partially offset by a higher level of deferred salaries directly related to successful loan originations in 2015, in addition to lower deferred compensation expense, reduced incentive compensation accruals and a drop in temporary help and overtime costs due to inflated costs in 2014 stemming from our core banking system conversion and acquisition. In 2014, compensation expense was impacted by regular annual salary increases as well as staffing costs associated with the acquisition. Furthermore, increases in our accrual for officer bonuses, group health insurance premiums, and the Company's matching contribution to its 401(k) plan added to expenses in 2014, as did non-recurring temporary help and overtime costs related to our core conversion and acquisition. Lower stock option expense in 2014 partially offset the aforementioned increases. Components of compensation expense that can experience significant variability and are typically difficult to predict include salaries associated with successful loan originations, which are accounted for in accordance with Financial Accounting Standards Board ("FASB") guidelines on the recognition and measurement of non-refundable fees and origination costs for lending activities, and accruals associated with employee deferred compensation plans. Loan origination salaries that were deferred from current expense for recognition over the life of related loans totaled $3.058 million for 2015, $2.673 million for 2014, and $2.804 million in 2013, with the fluctuations due to variability in successful organic loan origination activity.

Employee deferred compensation expense accruals totaled $37,000 in 2015, relative to $239,000 in 2014 and $451,000 in 2013. As noted above in our discussion of BOLI income, employee deferred compensation plan accruals are related to separate account BOLI income and losses, as are directors deferred compensation accruals that are included in “other professional services,” and the net income impact of all income/expense accruals related to deferred compensation is usually minimal. Salaries and benefits were 49.05% of total operating expense in 2015, relative to 49.44% in 2014 and 48.91% in 2013. The number of full-time equivalent staff employed by the Company totaled 417 at the end of 2015, 420 at the end of 2014, and 389 at the end of 2013. The increase in 2014 over 2013 is due to the addition of Santa Clara Valley Bank staff.

Total rent and occupancy expense, including furniture and equipment costs, increased by $555,000, or 9%, in 2015 over 2014, and by $70,000, or 1%, in 2014 over 2013. The increase in 2015 is due primarily to the three branches added via our acquisition in November 2014 and our loan production office that opened in May 2015, with associated expenses including but not limited to rent and depreciation, utilities, janitorial, and security. In 2014, premises costs increased relative to 2013 due to higher utilities expense and costs associated with our newly-acquired branches.

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Advertising and marketing costs were up by $114,000, or 5%, in 2015 over 2014, and by $245,000, or 13%, in 2014 over 2013. The increase for 2015 is due primarily to promotional expenses associated with our newer branches, while the increase in 2014 was due to non-recurring costs incurred in conjunction with our 2014 rebranding efforts and the acquisition, as well as an increase in charitable donations.

Data processing costs increased by $710,000, or 26%, in 2015 over 2014, and by $1.154 million, or 74%, in 2014 over 2013. The increase in 2015 is the result of ongoing costs related to the acquisition, as well as an increase in our cost structure subsequent to the core processing conversion in the first quarter of 2014. The increase in 2014 can be attributed to incremental ongoing costs stemming from our core banking system conversion and other technology upgrades, and the acquisition. Deposit services costs also increased by $595,000, or 23%, in 2015 over 2014, and $182,000, or 8%, in 2014 over 2013. As with data processing costs, much of the increase in deposit costs is the result of ongoing expenses associated with our software conversion and the acquisition, including $123,000 in amortization expense for our core deposit intangible, but deposit costs were further impacted by increases in internet banking, electronic check exchange, and debit card processing costs due to increased activity levels.

Loan services costs are comprised of loan processing costs and net costs associated with foreclosed assets. Loan processing costs, which include expenses for property appraisals and inspections, loan collections, demand and foreclosure activities, loan servicing, loan sales, and other miscellaneous lending costs, declined by $222,000, or 20%, in 2015 relative to 2014, but increased by $114,000, or 11%, in 2014 over 2013. The year-to-year fluctuations are due in large part to $290,000 in non-recurring commissions paid in conjunction with the sale of certain nonperforming loans in 2014. Foreclosed assets costs are comprised of write-downs taken subsequent to re-appraisals, OREO operating expense (including property taxes), and losses on the sale of foreclosed assets, net of rental income on OREO properties and gains on the sale of foreclosed assets. Those costs totaled $153,000 in 2015, but reflect a net expense reversal of $1.420 million for 2014 due to relatively large gains on the sale of OREO. Net expenses on foreclosed assets were $1.529 million in 2013. This line item thus reflects an increase of $1.573 million for 2015 over 2014, and a reduction of $2.949 million for 2014 relative to 2013. As noted, the largest impact on this category came from OREO sales, which produced a net gain of $259,000 in 2015, relative to a net gain of $2.253 million in 2014 and a net loss of $223,000 in 2013. OREO write-downs and OREO operating expense were down in 2015 relative to 2014, however, by $231,000 and $196,000, respectively, and also dropped in 2014 relative to 2013, by $277,000 and $227,000, respectively. Foreclosed asset expenses have been trending down in recent years as real estate values in our markets have improved and real estate sales activity has increased, but we do not expect a recurrence of large gains on the sale of OREO such as those realized in 2014.

The “other operating costs” category includes telecommunications expense, postage, and other miscellaneous costs. Telecommunications expense increased by $574,000, or 45%, in 2015 over 2014, but was reduced by $330,000, or 20%, in 2014 relative to 2013. The increase in 2015 and the reduction in 2014 were due in part to $155,000 in credits received in 2014 for prior-period overpayments. The increase for 2015 was also affected by expenses associated with the SCVB acquisition and our new loan production office, as well as upgraded circuits and certain redundant circuits that we are working to consolidate. The reduction in 2014 includes the impact of new contract rates and the incorporation of infrastructure efficiencies. Postage expense increased by $148,000, or 19%, in 2015 over 2014, and by $62,000, or 9%, in 2014 over 2013. The increase for 2015 is due to an increase in the volume of mailings related to compliance requirements, monthly statements, and customer education, while the increase in 2014 is primarily the result of additional mailings to customers in conjunction with our core banking system conversion, the rebranding initiative, and the acquisition. The "Other" category under other operating costs increased by $84,000, or 12%, in 2015 as a result of higher education and training costs, and was up $34,000, or 5%, in 2014 due primarily to staff travel and meal costs, which were higher than normal during the conversion and the acquisition.

Legal and accounting costs were up $93,000, or 7%, in 2015 over 2014, but declined $444,000, or 26%, in 2014 relative to 2013. The increase in 2015 is from higher costs for internal audits, partially offset by reduced legal expense and lower external audit costs. The drop in 2014 is due primarily to reduced loan review costs and lower lending-related legal expense incidental to our improvement in credit quality, as well as lower external audit expense.

Acquisition costs include one-time expenses directly attributable to our acquisition of Santa Clara Valley Bank, which totaled $101,000 in 2015 and $2.070 million in 2014. Those expenses are comprised primarily of financial advisor fees, legal costs, severance and retention amounts paid to SCVB employees, the write-off of furniture, fixtures and equipment that were not utilized by the Company, software conversion costs, and termination fees on certain SCVB contracts for redundant services.

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Other professional services costs include FDIC assessments and other regulatory costs, directors' costs, certain insurance costs, and professional recruiting fees among other things. This category fell by $325,000, or 15%, in 2015, and by $345,000, or 14%, in 2014. The drop in 2015 was due to reductions in regulatory assessments, deferred compensation expense for directors, and stock option expense for directors. For 2014, the drop includes reductions in regulatory assessments and deferred compensation expense. As with deferred compensation accruals for employees, directors' deferred fee accruals are related to separate account BOLI income and losses, and the net income impact of all income/expense accruals related to deferred compensation is usually minimal. Directors' deferred compensation expense accruals totaled $57,000 in 2015, $197,000 in 2014, and $482,000 in 2013.

Stationery and supply costs increased by $104,000, or 9%, in 2015 over 2014, and by $535,000, or 81%, in 2014 over 2013. The increases for both 2015 and 2014 are primarily due to recurring costs stemming from our whole-bank acquisition and core conversion in 2014, but the increase in 2014 was also impacted by the rebranding initiative. Sundry and teller costs increased by $349,000, or 68%, in 2015 and by $156,000, or 44%, in 2014, due to an increase in debit card losses and other operations-related charge-offs. We are hopeful that our conversion to EMV technology, being phased in over the fourth quarter of 2015 and the first quarter of 2016, will help reduce debit card fraud, but no assurance can be provided in that regard.

The Company's tax-equivalent overhead efficiency ratio improved to 63.98% in 2015, from 66.48% in 2014 and 65.95% in 2013. The overhead efficiency ratio represents total non-interest expense divided by the sum of fully tax-equivalent net interest and non-interest income, with the provision for loan losses and investment gains/losses excluded from the equation.

Income Taxes

Our income tax provision was $9.071 million, or 33% of pre-tax income in 2015, relative to a provision of $6.191 million, or 29% of pre-tax income in 2014 and a provision of $3.093 million, or 19% of pre-tax income in 2013. Higher taxable income and a declining level of available tax credits were the primary factors impacting the increase in our tax accrual rate in 2015.

The Company sets aside a provision for income taxes on a monthly basis. The amount of that provision is determined by first applying the Company's statutory income tax rates to estimated taxable income, which is pre-tax book income adjusted for permanent differences, and then subtracting available tax credits. Permanent differences include but are not limited to tax-exempt interest income, BOLI income, and certain book expenses that are not allowed as tax deductions. The Company's investments in state, county and municipal bonds provided $2.953 million in federal tax-exempt income in 2015, $2.936 million in 2014, and $2.737 million in 2013. Our bank-owned life insurance also generated $907,000 in tax-exempt income in 2015, down from $1.278 million in 2014 and $1.787 million in 2013.

Effective January 1, 2014, changes in California tax law eliminated certain state tax credits and deductions, which had a negative impact on our tax accrual rate. Tax credits currently include any remaining California state tax employment credits, as well as those generated by our investments in low-income housing tax credit funds. We had a total of $4.9 million invested in low-income housing tax credit funds as of December 31, 2015, which are included in other assets rather than in our investment portfolio. Those investments have generated substantial tax credits over the past few years, with about $770,000 in credits available for the 2015 tax year, $1.0 million in tax credits utilized in 2014, and $1.3 million in tax credits utilized in 2013. The credits are dependent upon the occupancy level of the housing projects and income of the tenants, and cannot be projected with certainty. Furthermore, our capacity to utilize them will continue to depend on our ability to generate sufficient pre-tax income. Because we have not invested in additional tax credit funds for the past few years, the level of low-income housing tax credits will taper off in future years until they are substantially utilized by the end of 2018. That means that even if taxable income stayed at the same level through 2018, our tax accrual rate would gradually increase.

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Financial Condition

Assets totaled $1.797 billion at the end of 2015, reflecting an increase of $159 million, or 10%, for the year due to growth in loans that was partially offset by slightly lower cash balances and investments. Loan volume was favorably impacted by increased utilization on mortgage warehouse lines, the first quarter purchase of residential mortgage loans, and strong organic growth. Total nonperforming assets continued to trend down in 2015, including a significant reduction in the fourth quarter pursuant to the sale of our single largest remaining nonperforming loan, and our allowance for loan and lease losses was reduced due to the improvement in asset quality. Total deposits experienced a large increase in 2015 as a result of continued core deposit growth in our branches, and non-deposit borrowings were also increased to support our strong loan growth.

Total capital was up only $3 million for the year in 2015, since the addition of net income to retained earnings and the positive impact of stock options exercised were largely offset by the Company's repurchase of shares, the payment of cash dividends, and a drop in accumulated other comprehensive income. Nevertheless, capital remains at relatively high levels in comparison to peer banks. We have, in fact, maintained a very strong capital position throughout the recession and in the ensuing years, due to our registered direct offering in 2010 and private placement in 2009 combined with increases from retained earnings in the normal course of business. Furthermore, our liquidity position has been exceptionally strong for the past few years due to robust growth in customer deposits and the runoff of wholesale-sourced brokered deposits, in addition to relatively high levels of unpledged liquid investments. Our healthy capital position and access to liquidity resources position us to take advantage of potential growth opportunities, although no assurance can be provided in that regard. The major components of the Company's balance sheet are individually analyzed below, along with information on off-balance sheet activities and exposure.

Loan and Lease Portfolio

The Company's loan and lease portfolio represents the single largest portion of invested assets, substantially greater than the investment portfolio or any other asset category, and the quality and diversification of the loan and lease portfolio are important considerations when reviewing the Company's financial condition. The Company is not involved with chemicals or toxins that might have an adverse effect on the environment, thus its primary exposure to environmental legislation is through its lending activities. The Company's lending procedures include steps to identify and monitor this exposure in an effort to avoid any related loss or liability.

The Selected Financial Data table in Item 6 above reflects the amount of loans and leases outstanding at December 31st for each year from 2011 through 2015, net of deferred fees and origination costs and the allowance for loan and lease losses. The Loan and Lease Distribution table that follows sets forth by loan type the Company's gross loans and leases outstanding, and the percentage distribution in each category at the dates indicated. The balances for each loan type include nonperforming loans, if any, but do not reflect any deferred or unamortized loan origination, extension, or commitment fees, or deferred loan origination costs. Although not reflected in the loan totals below and not currently comprising a material part of our lending activities, the Company occasionally originates and sells, or participates out portions of, loans to non-affiliated investors.

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Loan and Lease Distribution

(dollars in thousands)

	As of December 31, 2015	2014	2013	2012	2011
Real Estate:					
1-4 family residential construction	$14,941	$5,858	$1,720	$3,174	$8,488
Other Construction/Land	37,359	19,908	25,531	28,002	40,060
1-4 family - closed-end	137,356	114,259	87,024	99,917	104,953
Equity Lines	44,233	49,717	53,723	61,463	66,497
Multi-family residential	27,222	18,718	8,485	5,960	8,179
Commercial RE- owner occupied	218,708	218,654	186,012	182,614	183,070
Commercial RE- non-owner occupied	165,107	132,077	106,840	92,808	105,843
Farmland	133,182	145,039	108,504	71,851	60,142
Total Real Estate	778,108	704,230	577,839	545,789	577,232
Agricultural	46,237	27,746	25,180	22,482	17,078
Commercial and Industrial	113,207	113,771	103,262	112,328	98,933
Mortgage Warehouse Lines	180,355	106,021	73,425	170,324	28,224
Consumer loans	14,949	18,885	23,536	28,872	36,124
Total Loans and Leases	$1,132,856	$970,653	$803,242	$879,795	$757,591
Percentage of Total Loans and Leases					
Real Estate:					
1-4 family residential construction	1.32 %	0.60 %	0.21 %	0.35 %	1.12 %
Other Construction/land	3.30 %	2.05 %	3.18 %	3.18 %	5.29 %
1-4 family - closed-end	12.12 %	11.77 %	10.83 %	11.36 %	13.85 %
Equity Lines	3.90 %	5.12 %	6.69 %	6.99 %	8.78 %
Multi-family residential	2.40 %	1.93 %	1.06 %	0.68 %	1.08 %
Commercial RE- owner occupied	19.31 %	22.53 %	23.16 %	20.76 %	24.16 %
Commercial RE- non-owner occupied	14.57 %	13.61 %	13.30 %	10.55 %	13.97 %
Farmland	11.76 %	14.94 %	13.51 %	8.17 %	7.94 %
Total Real Estate	68.68 %	72.55 %	71.94 %	62.04 %	76.19 %
Agricultural	4.08 %	2.86 %	3.13 %	2.56 %	2.25 %
Commercial and Industrial	9.99 %	11.72 %	12.86 %	12.76 %	13.06 %
Mortgage Warehouse Lines	15.93 %	10.92 %	9.14 %	19.36 %	3.73 %
Consumer loans	1.32 %	1.95 %	2.93 %	3.28 %	4.77 %
	100.00 %	100.00 %	100.00 %	100.00 %	100.00 %

Excluding the fluctuations caused by variability in outstanding balances on mortgage warehouse lines, the Company experienced limited growth, or in some instances runoff, in other loan and lease balances from 2011 through 2013 due to reductions associated with the resolution of impaired loans, weak loan demand, stringent underwriting standards, and intense competition. In 2014, however, net growth in outstanding balances totaled $167 million, or 21%, with only $33 million of that growth coming from mortgage warehouse loans. The Company’s loan growth in 2014 includes $62 million in SCVB loans, the purchase of $33 million in residential mortgage loans, and strong organic growth in agricultural real estate loans, commercial real estate loans, and commercial loans. Loan growth continued at a sturdy pace in 2015 with a net increase of $162 million, or 17%, in gross loan balances resulting from increased utilization on mortgage warehouse lines, the purchase of $28 million in residential mortgage loans, strong organic growth in other non-farm real estate loans, and a solid increase in agricultural production loans.

Outstanding balances on mortgage warehouse lines were up $74 million, or 70%, as utilization on lines increased to 60% at December 31, 2015 from 47% at December 31, 2014, and certain lines were judiciously increased during 2015 to accommodate strong borrower demand. Mortgage lending activity is highly correlated with changes in interest rates and refinancing activity and has historically been subject to significant fluctuations, so no assurance can be provided with regard to our ability to maintain or grow mortgage warehouse balances.

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Non-owner occupied commercial real estate loans increased by $33 million, or 25%, in 2015 due to focused loan origination efforts and escalating commercial real estate activity in certain markets in our footprint. Management expects continued growth in commercial real estate loans based on the current pipeline of loans in the process of approval, although no assurance can be provided in that regard. Real estate loans classified as 1-4 family closed-end loans were also up $23 million, or 20%, during 2015 due to the aforementioned opportunistic purchase of well-underwritten, newer vintage residential mortgage loans which had an expected average life of about seven years at the time of purchase. Material increases are likewise evident in residential construction loans, which grew $9 million, or 155% during 2015, non-residential construction loans, which were up $17 million, or 88%, and multi-family residential loans, which increased almost $9 million, or 45%. Other real estate loan categories either remained static, or declined as loan payoffs outpaced new originations. Loans secured by farmland, in particular, were down $12 million, or 8%, due in part to the payoff of a large dairy loan subsequent to the sale of the business by the borrower.

Agricultural production loans also experienced significant growth in 2015, increasing by about $18 million, or 67%. Consumer loans, on the other hand, were down $4 million, or 21%, due to weak demand and tightened credit criteria. Commercial loans were roughly unchanged for the year.

Loan and Lease Maturities

The following table shows the maturity distribution for total loans and leases outstanding as of December 31, 2015, including non-accruing loans, grouped by remaining scheduled principal payments:

Loans and Lease Maturity

(dollars in thousands)

	As of December 31, 2015						
	Three months or less	Three months to twelve months	One to five years	Over five years	Total	Floating rate: due after one year	Fixed rate: due after one year
Real Estate	$17,246	$ 38,526	$ 79,883	$ 642,453	$778,108	$ 430,317	$ 292,019
Agricultural	2,826	29,421	12,163	1,827	46,237	3,703	10,287
Commercial and Industrial	6,835	31,489	23,245	51,638	113,207	22,893	51,990

Mortgage warehouse lines	-	180,355	-	-	180,355	-	-
Consumer Loans	654	734	5,683	7,878	14,949	789	12,772
Total	$27,561	$ 280,525	$ 120,974	$ 703,796	$1,132,856	$ 457,702	$ 367,068

For a comprehensive discussion of the Company's liquidity position, balance sheet re-pricing characteristics, and sensitivity to interest rates changes, refer to the "Liquidity and Market Risk" section of this discussion and analysis.

Off-Balance Sheet Arrangements

The Company makes commitments to extend credit to its customers in the normal course of business, as long as there are no violations of conditions established in contractual arrangements. The effect on the Company's revenues, expenses, cash flows and liquidity from unused portions of commitments to provide credit cannot be reasonably predicted, because there is no certainty that lines of credit will ever be fully utilized. Unused commitments to extend credit totaled $355 million, or 31% of gross loans and leases outstanding at December 31, 2015, as compared to $367 million, or 38% of gross loans and leases outstanding at December 31, 2014. In addition to unused loan commitments, the Company had undrawn letters of credit totaling $17 million at December 31, 2015 and $14 million at December 31, 2014. Off-balance sheet obligations pose potential credit risk to the Company, and a $304,000 reserve for unfunded commitments is reflected as a liability in our consolidated balance sheet at December 31, 2015. For more information regarding the Company's off-balance sheet arrangements, see Note 11 to the consolidated financial statements in Item 8 herein.

Contractual Obligations

At the end of 2015, the Company had contractual obligations for the following payments, by type and period due:

Contractual Obligations

(dollars in thousands)

	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Long-term debt obligations	$32,928	$ 2,000	$ -	$ -	$ 30,928
Operating lease obligations	8,159	1,190	2,185	1,577	3,207
Other long-term obligations	795				795
Total	$41,882	$ 3,190	$ 2,185	$ 1,577	$ 34,930

Nonperforming Assets

Nonperforming assets (“NPAs”) are comprised of loans for which the Company is no longer accruing interest, and foreclosed assets including mobile homes and OREO. If the Company grants a concession to a borrower in financial difficulty, the loan falls into the category of a troubled debt restructuring (“TDR”), which may be classified as either nonperforming or performing depending on the loan’s accrual status. The following table presents comparative data for the Company’s NPAs and performing TDRs as of the dates noted:

Nonperforming Assets and Performing TDRs

(dollars in thousands)

	As of December 31,				
	2015	2014	2013	2012	2011
Real Estate:					
1-4 family residential construction	$-	$-	$-	$153	$2,244
Other Construction/Land	457	3,547	5,528	11,163	4,083
1-4 family - closed-end	2,298	3,042	13,168	15,381	7,605

Equity Lines	1,770	1,049	778	1,026	1,309
Multi-family residential	630	171	-	-	2,941
Commercial RE- owner occupied	2,325	3,417	5,516	5,314	7,086
Commercial RE- non-owner occupied	262	7,754	8,058	11,642	13,958
Farmland	610	51	282	1,933	6,919
TOTAL REAL ESTATE	8,352	19,031	33,330	46,612	46,145
Agricultural	-	-	470	664	-
Commercial and Industrial	710	821	2,622	4,545	7,230
Direct finance leases	-	-	-	135	591
Consumer loans	572	826	992	1,138	2,144
TOTAL NONPERFORMING LOANS (1)	$9,634	$20,678	$37,414	$53,094	$56,110
Foreclosed assets	3,193	3,991	8,185	19,754	15,364
Total nonperforming assets	$12,827	$24,669	$45,599	$72,848	$71,474
Performing TDRs (1)	$12,431	$12,359	$15,239	$18,652	$36,058
Nonperforming loans as a % of total gross loans and leases	0.85 %	2.13 %	4.66 %	6.03 %	7.41 %
Nonperforming assets as a % of total gross loans and leases and foreclosed assets	1.13 %	2.53 %	5.62 %	8.10 %	9.25 %

(1) Performing TDRs are not included in nonperforming loans above, nor are they included in the numerators used to calculate the ratios disclosed in this table.

At the end of 2006, prior to the recession, our NPAs totaled less than $1 million and comprised only 0.08% of total loans and leases plus foreclosed assets. They subsequently escalated to as high as $80 million, or close to 9% of total loans and leases plus foreclosed assets at September 30, 2009, due to deterioration in the economy and the associated negative impact on our borrowers. By the end of 2015 total NPAs had been reduced to $12.8 million, or about 1% of gross loans and leases plus foreclosed assets, in response to better economic conditions and our continuous concerted efforts to improve credit quality. This contraction in NPAs includes a drop of $12 million, or 48%, during 2015, comprised of an $11 million reduction in nonperforming loans and a $1 million reduction in foreclosed assets. The balance of nonperforming loans at December 31, 2015 includes $6.9 million in TDRs and other loans that were paying as agreed under modified terms or forbearance agreements but were still classified as nonperforming. We also had $12.4 million in loans classified as performing TDRs for which we were still accruing interest at December 31, 2015, approximately the same level as performing TDRs at December 31, 2014. Notes 2 and 4 to the consolidated financial statements provide a more comprehensive disclosure of TDR balances and activity within recent periods.

Non-accruing loan balances secured by real estate comprised $8.4 million of total nonperforming loans at December 31, 2015, down $10.7 million, or 56%, since December 31, 2014. The gross reduction in nonperforming real estate loans totaled $19.4 million during 2015, but reductions were partially offset by the migration of $8.7 million in real estate loans to non-accrual status. Nonperforming commercial loans declined by $111,000, or 14%, in 2015, ending the period at $710,000. Nonperforming consumer loans, which are largely unsecured, declined by $254,000, or 31%, to a balance of $572,000 at December 31, 2015.

As noted above, foreclosed assets were reduced by $798,000, or 20%, in 2015 due primarily to OREO sold, but write-downs on OREO contributed $221,000 to the reduction. Our foreclosed assets had an aggregate carrying value of $3.2 million at December 31, 2015, and were comprised of 16 properties classified as OREO and two mobile homes. At the end of 2014 foreclosed assets totaled $4.0 million, consisting of 24 properties classified as OREO and three mobile homes. All foreclosed assets are periodically evaluated and written down to their fair value less expected disposition costs, if lower than the then-current carrying value.

An action plan is in place for each of our non-accruing loans and foreclosed assets and they are all being actively managed. Collection efforts are continuously pursued for all nonperforming loans, but no assurance can be provided that they will be resolved in a timely manner or that nonperforming balances will not increase.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses, a contra-asset, is established through a provision for loan and lease losses. It is maintained at a level that is considered adequate to absorb probable losses on specifically identified impaired loans, as well as probable incurred losses inherent in the remaining loan portfolio. Specifically identifiable and quantifiable losses are immediately charged off against the allowance; recoveries are generally recorded only when sufficient cash payments are received subsequent to the charge off. Note 2 to the consolidated financial statements provides a more comprehensive discussion of the accounting guidance we conform to and the methodology we use to determine an appropriate allowance for loan and lease losses.

The Company’s allowance for loan and lease losses was $10.4 million, or 0.92% of gross loans at December 31, 2015, relative to $11.2 million, or 1.16% of gross loans at December 31, 2014. The decline in the allowance in 2015 was facilitated by the fact that many loan charge-offs during the period were charged against loss reserves established in previous periods and therefore did not lead to the need for reserve replenishment. Moreover, while the lower allowance for loan and lease losses is not directionally consistent with the increase in outstanding loan balances, our need for an additional allowance was favorably impacted by loan growth occurring in portfolio segments with low historical loss rates, and credit quality improvement in the remainder of the performing loan portfolio. The ratio of the allowance to nonperforming loans was 108.19% at December 31, 2015, relative to 54.40% at December 31, 2014 and 31.21% at December 31, 2013. A separate allowance for potential losses inherent in unused commitments is included in other liabilities, and totaled $304,000 at December 31, 2015.

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The table that follows summarizes the activity in the allowance for loan and lease losses for the periods indicated:

Allowance for Loan and Lease Losses

(dollars in thousands)

	As of and for the years ended December 31,				
Balances:	2015	2014	2013	2012	2011
Average gross loans and leases outstanding during period	$1,027,983	$859,981	$804,533	$789,333	$767,901
Gross loans and leases held for investment	$1,132,856	$970,653	$803,242	$879,795	$757,591
Allowance for Loan and Lease Losses:					
Balance at beginning of period	$11,248	$11,677	$13,873	$17,283	$21,138
Provision charged to expense	-	350	4,350	14,210	12,000
Charge-offs					
Real Estate:					
1-4 family residential construction	-	-	-	46	1,389
Other Construction/Land	73	135	625	1,994	1,807
1-4 Family - closed-end	224	431	454	1,763	795
Equity Lines	92	828	1,131	1,234	1,776
Multi-family residential	-	-	-	1,262	-
Commercial RE- owner occupied	318	171	933	2,117	1,306
Commercial RE - non-owner occupied	-	45	523	2,522	3,027
Farmland	-	19	539	170	496
TOTAL REAL ESTATE	707	1,629	4,205	11,108	10,596
Agricultural	-	124	473	634	-
Commercial and Industrial	395	625	1,668	4,468	3,637
Mortgage Warehouse Lines	-	-	-	-	-
Consumer Loans	1,738	1,837	1,917	2,568	2,754
Total	2,840	4,215	8,263	18,778	16,987
Recoveries					
Real Estate:					
1-4 family residential construction	-	38	-	7	133
Other Construction/Land	117	702	174	61	38
1-4 Family - closed-end	93	317	58	40	23
Equity Lines	189	273	118	21	4
Multi-family residential	-	-	36	-	-
Commercial RE- owner occupied	106	504	60	104	71
Commercial RE - non-owner occupied	246	79	172	12	148
Farmland	-	-	-	57	1
TOTAL REAL ESTATE	751	1,913	618	302	418
Agricultural	81	6	-	-	-

Commercial and Industrial	225	801	802	578	451
Mortgage Warehouse Lines	-	-	-	-	-
Consumer Loans	958	716	297	278	263
Total	2,015	3,436	1,717	1,158	1,132
Net loan charge offs (recoveries)	825	779	6,546	17,620	15,855
Balance	$10,423	$11,248	$11,677	$13,873	$17,283
RATIOS					
Net Loan and Lease Charge-offs to Average Loans and Leases	0.08 %	0.09 %	0.81 %	2.23 %	2.06 %
Allowance for Loan and Lease Losses to Gross Loans and Leases at End of Period	0.92 %	1.16 %	1.45 %	1.58 %	2.28 %
Allowance for Loan Losses to Non-Performing Loans	108.19 %	54.40 %	31.21 %	26.13 %	30.80 %
Net Loan and Lease Charge-offs to Allowance for Loan Losses at End of Period	7.92 %	6.93 %	56.06 %	127.01 %	91.74 %
Net Loan Charge-offs to Provision for Loan and Lease Losses	-	222.57 %	150.48 %	124.00 %	132.13 %

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As shown in the table above, the Company did not record a provision for loan and lease losses in 2015 but had a provision of $350,000 in 2014. There were net loan charge-offs of $825,000 in 2015, relative to $779,000 in 2014. Any shortfall in the allowance resulting from loan charge-offs, or a deficit identified pursuant to our analysis of remaining probable losses, is always covered by quarter-end. Our allowance for probable losses on specifically identified impaired loans was reduced by $1.536 million, or 28%, during 2015, due to the charge-off of losses against the allowance and the release of reserves subsequent to the resolution of certain non-performing loans. The allowance for probable losses inherent in non-impaired loans increased by $711,000, or 12%, during 2015 as a result of higher loan balances, as well as qualitative factor adjustments for the estimated impact of the drought and the drop in oil prices on credit quality. The "Provision for Loan and Lease Losses" section above includes additional details on our provision and its relationship to actual charge-offs.

Provided below is a summary of the allocation of the allowance for loan and lease losses for specific loan categories at the dates indicated. The allocation presented should not be viewed as an indication that charges to the allowance will be incurred in these amounts or proportions, or that the portion of the allowance allocated to a particular loan category represents the total amount available for charge-offs that may occur within that category.

<u>Allocation of Allowance for Loan and Lease Losses</u>

(dollars in thousands)

	As of December 31, 2015			2014			2013			2012			2011		
	Amount	%Total [1] Loans		Amount	%Total [1] Loans		Amount	%Total [1] Loans		Amount	%Total [1] Loans		Amount	%Total [1] Loans	
Real Estate	$4,783	68.68	%	$6,243	72.55	%	$5,544	71.94	%	$8,034	62.04	%	$8,260	76.19	%
Agricultural	722	4.08	%	986	2.86	%	978	3.13	%	258	2.56	%	19	2.26	%
Commercial and Industrial[2]	2,533	25.92	%	1,944	22.64	%	3,787	22.00	%	3,467	32.12	%	6,396	16.78	%
Consumer Loans	1,263	1.32	%	1,765	1.95	%	1,117	2.93	%	2,114	3.28	%	2,608	4.77	%
Unallocated	1,122	-		310	-		251	-		-	-		-	-	
Total	$10,423	100.00	%	$11,248	100.00	%	$11,677	100.00	%	$13,873	100.00	%	$17,283	100.00	%

[1] Represents percentage of loans in category to total loans

[2] Includes mortgage warehouse lines

The Company’s allowance for loan and lease losses at December 31, 2015 represents management’s best estimate of probable losses in the loan portfolio as of that date, but no assurance can be given that the Company will not experience substantial losses relative to the size of the allowance. Furthermore, fluctuations in credit quality, changes in economic conditions, updated accounting or regulatory requirements, and/or other factors could induce us to augment or reduce the allowance.

Investments

The Company’s investments can at any given time consist of debt and marketable equity securities (together, the “investment portfolio”), investments in the time deposits of other banks, surplus interest-earning balances in our Federal Reserve Bank account, and overnight fed funds sold. Surplus FRB balances and fed funds sold to correspondent banks represent the temporary investment of excess liquidity. The Company’s investments serve several purposes: 1) they provide liquidity to even out cash flows from the loan and deposit activities of customers; 2) they provide a source of pledged assets for securing public deposits, bankruptcy deposits and certain borrowed funds which require collateral; 3) they constitute a large base of assets with maturity and interest rate characteristics that can be changed more readily than the loan portfolio, to better match changes in the deposit base and other funding sources of the Company; 4) they are another interest-earning option for surplus funds when loan demand is light; and 5) they can provide partially tax exempt income. Aggregate investments totaled $510 million, or 28% of total assets at December 31, 2015, compared to $514 million, or 31% of total assets at December 31, 2014.

We had no fed funds sold at December 31, 2015 or 2014, but interest-bearing balances held at other banks increased slightly, to about $2 million at December 31, 2015, due to the timing of cash flows in our FRB account. The Company's investment portfolio reflects a reduction of $4 million, or less than 1%, during 2015, ending the period with a book balance of $508 million. The Company carries investments at their fair market values. Although we currently have the intent and ability to hold our investment securities 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. The expected average life for all bonds in our investment portfolio was 3.9 years and their average effective duration was 2.5 years as of December 31, 2015, both up slightly relative to year-end 2014.

The following Investment Portfolio table reflects the amortized cost and fair market values for each primary category of investments for the past three years:

Investment Portfolio-Available for Sale

(dollars in thousands)

	As of December 31, 2015		2014		2013	
	Amortized Cost	Fair Market Value	Amortized Cost	Fair Market Value	Amortized Cost	Fair Market Value
US Government Agencies	$28,801	$ 29,042	$26,959	$ 27,270	$5,395	$ 5,304
Mortgage-backed securities	374,683	375,061	378,339	381,442	320,223	320,721
State and political subdivisions	99,093	102,183	98,056	100,949	97,361	96,563
Equity securities	575	1,296	1,210	2,222	1,336	2,456
Total securities	$503,152	$ 507,582	$504,564	$ 511,883	$424,315	$ 425,044

The net unrealized gain on our investment portfolio, or the difference between the fair market value and amortized cost, was $4.4 million at December 31, 2015, down from a net unrealized gain of $7.3 million at December 31, 2014 due to higher interest rates. The value of U.S. Government agency securities increased by $2 million, or 6%, during 2015, due to bond purchases net of sales and maturities. Mortgage-backed securities were down $6 million, or 2%, due prepayments and lower market values. Municipal bonds were up by $1 million, or 1%, since bond purchases offset the decline in market values. All newly purchased municipal bonds have strong underlying ratings, and all municipal bonds in our portfolio are evaluated quarterly for potential impairment. The market value of equity securities reflects a drop of $926,000, or 42%, for the year, since we sold certain of our investments for realized gains of $506,000.

Investment securities pledged as collateral for Federal Home Loan Bank of San Francisco (“FHLB”) borrowings, repurchase agreements, public deposits and other purposes as required or permitted by law totaled $180 million at December 31, 2015 and $141 million at December 31, 2014, leaving $326 million in unpledged debt securities at December 31, 2015 and $369 million at December 31, 2014. Securities pledged in excess of actual pledging needs and thus available for liquidity purposes, if necessary, totaled $57 million at December 31, 2015 and $25 million at December 31, 2014.

The investment maturities table below summarizes contractual maturities for the Company’s investment securities and their weighted average yields at December 31, 2015. The actual timing of principal payments may differ from remaining contractual maturities, because obligors may have the right to prepay certain obligations.

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Maturity and Yield of Available for Sale Investment Portfolio

(dollars in thousands)

	December 31, 2015									
	Within One Year		After One But Within Five Years		After Five Years But Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
US government agencies	$ 500	3.39 %	$ 18,096	2.17 %	$ 8,083	2.49 %	$ 2,363	3.39 %	$ 29,042	2.38 %
Mortgage-backed securities	1,788	1.78 %	358,917	2.02 %	13,925	2.69 %	431	1.58 %	375,061	2.05 %
State and political subdivisions	3,207	6.14 %	18,853	6.02 %	31,245	4.36 %	48,878	4.12 %	102,183	4.61 %
Other equity securities	-	-	-	-	-	-	1,296	-	1,296	-
Total securities	$ 5,495		$ 395,866		$ 53,253		$ 52,968		$ 507,582	

Cash and Due from Banks

Cash on hand and non-interest bearing balances due from correspondent banks totaled $47 million, or 3% of total assets at December 31, 2015, and $48 million, or 3% of total assets at December 31, 2014. The actual balance of cash and due from banks at any given time depends on the timing of collection of outstanding cash items (checks), among other things, and is subject to significant fluctuation in the normal course of business. While cash flows are normally predictable within limits, those limits are fairly broad and the Company manages its short-term cash position through the utilization of overnight loans to and borrowings from correspondent banks, interest-earning deposits in and borrowings from the Federal Reserve Bank, and borrowings from the Federal Home Loan Bank. Should a large “short” overnight position persist for any length of time, the Company typically raises money through focused retail deposit gathering efforts or by adding brokered time deposits. If a “long” position is prevalent, the Company will let brokered deposits or other wholesale borrowings roll off as they mature, or might invest excess liquidity in higher-yielding, longer-term bonds. Because of frequent balance fluctuations, a more accurate gauge of cash management efficiency is the average balance for the period. Our $42 million average for non-earning cash and due from banks in 2015 is $3 million higher than the average for 2014, due primarily to cash on hand at the SCVB branches added in November 2014. The average is expected to increase again in 2016, due to cash needed for additional branches coming online during the course of the year.

Premises and Equipment

Premises and equipment are stated on our books at cost, less accumulated depreciation and amortization. The cost of furniture and equipment is expensed as depreciation over the estimated useful life of the related assets, and leasehold improvements are amortized over the term of the related lease or the estimated useful life of the improvements, whichever is shorter. The following premises and equipment table reflects the original cost, accumulated depreciation and amortization, and net book value of fixed assets by major category, for the years noted:

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Premises and Equipment

(dollars in thousands)

	As of December 31, 2015			2014			2013		
	Cost	Accumulated Depreciation and Ammortization	Net Book Value	Cost	Accumulated Depreciation and Ammortization	Net Book Value	Cost	Accumulated Depreciation and Ammortization	Net Book Value
Land	$3,019	$ -	$ 3,019	$3,019	$ -	$ 3,019	$2,607	$ -	$ 2,607
Buildings	16,398	8,523	7,875	16,348	8,105	8,243	15,818	7,689	8,129
Furniture and equipment	18,166	12,936	5,230	18,397	13,919	4,478	17,829	14,487	3,342
Leasehold improvements	11,049	5,367	5,682	10,850	4,784	6,066	10,536	4,226	6,310
Construction in progress	184	-	184	47	-	47	5	-	5
Total	$48,816	$ 26,826	$ 21,990	$48,661	$ 26,808	$ 21,853	$46,795	$ 26,402	$ 20,393

Net premises and equipment increased by $137,000, or less than 1%, in 2015, due mainly to the capitalization of improvements at the SCVB branches less depreciation on all premises and equipment. The net book value of the Company’s premises and equipment was 1.2% of total assets at December 31, 2015 and 1.3% at December 31, 2014. Depreciation and amortization included in occupancy and equipment expense totaled $2.3 million in 2015, as compared to $2.1 million for 2014.

Other Assets

The Company’s goodwill and other intangible assets totaled $7.8 million at December 31, 2015, relative to $8.0 million at December 31, 2014. The decline during 2015 represents amortization of the core deposit intangible created by our acquisition of Santa Clara Valley Bank. The Company’s goodwill and other intangible assets are evaluated annually for potential impairment, and pursuant to that analysis management has determined that no impairment exists as of December 31, 2015.

The net cash surrender value of bank-owned life insurance increased to $44.1 million at December 31, 2015 from $43.0 million at December 31, 2014, due to the addition of BOLI income to the outstanding net cash surrender value during the course of the year. Refer to the “Non-Interest Revenue and Operating Expense” section above for a more detailed discussion of BOLI and the income it generates.

The line item for “other assets” on the Company’s balance sheet totaled $38.6 million at December 31, 2015, an increase of $1.1 million relative to $37.5 million at December 31, 2014. At year-end 2015, other assets included as its largest components a net deferred tax asset of $12.3 million, a $7.5 million investment in restricted stock, accrued interest receivable totaling $5.8 million, a $4.9 million investment in low-income housing tax credit funds, and a $1.4 million investment in a small business investment corporation. Restricted stock is comprised primarily of FHLB stock held in conjunction with our FHLB borrowings, and is not deemed to be marketable or liquid. Our net deferred tax asset is evaluated as of every reporting date pursuant to FASB guidance, and we have determined that no impairment exists.

Deposits

Deposits are another key balance sheet component impacting the Company’s net interest margin and other profitability metrics. Deposits provide liquidity to fund growth in earning assets, and the Company’s net interest margin is improved to the extent that growth in deposits is concentrated in less volatile and typically less costly non-maturity deposits such as demand deposit accounts, NOW accounts, savings accounts, and money market demand accounts. Information concerning average balances and rates paid by deposit type for the past three fiscal years is contained in the Distribution, Rate, and Yield table located in the previous section under Results of Operations–Net Interest Income and Net Interest Margin. A distribution of the Company’s deposits showing the balance and percentage of total deposits by type is presented for the noted periods in the following table:

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Deposit Distribution

(dollars in thousands)

	Year Ended December 31,				
	2015	2014	2013	2012	2011
Interest Bearing Demand Deposits	$125,210	$110,840	$82,408	$84,655	$68,777
Non-interest Bearing Demand Deposits	432,251	390,897	365,997	352,597	300,045
NOW	306,630	275,494	200,313	196,771	187,155
Savings	193,052	167,655	144,162	118,547	91,376
Money Market	101,562	117,907	73,132	71,222	76,396
CDAR's < $100,000	306	572	437	791	943
CDAR's ≥ $100,000	13,803	10,727	12,919	14,274	17,119
Customer Time deposit < $100,000	75,069	79,292	79,261	101,893	106,610
Customer Time deposits ≥ $100,000	216,745	208,311	205,550	218,284	222,847
Brokered Deposits	-	5,000	10,000	15,000	15,000
Total Deposits	$1,464,628	$1,366,695	$1,174,179	$1,174,034	$1,086,268

Percentage of Total Deposits					
Interest Bearing Demand Deposits	8.55 %	8.11 %	7.02 %	7.21 %	6.33 %
Non-interest Bearing Demand Deposits	29.51 %	28.60 %	31.17 %	30.03 %	27.62 %
NOW	20.94 %	20.16 %	17.06 %	16.76 %	17.23 %
Savings	13.18 %	12.27 %	12.28 %	10.10 %	8.41 %
Money Market	6.93 %	8.63 %	6.23 %	6.07 %	7.03 %
CDAR's < $100,000	0.02 %	0.04 %	0.04 %	0.07 %	0.09 %
CDAR's ≥ $100,000	0.94 %	0.78 %	1.10 %	1.22 %	1.58 %
Customer Time deposit < $100,000	5.13 %	5.80 %	6.75 %	8.68 %	9.81 %
Customer Time deposits ≥ $100,000	14.80 %	15.24 %	17.50 %	18.58 %	20.52 %
Brokered Deposits	-	0.37 %	0.85 %	1.28 %	1.38 %
Total	100.00 %	100.00 %	100.00 %	100.00 %	100.00 %

Total deposit balances increased by $98 million, or 7%, during 2015 due to strong organic growth in core non-maturity deposits. Non-maturity deposits were up $96 million, or 9%, for the year. The growth in non-maturity deposits during 2015 occurred in transaction accounts, comprised of demand deposits and NOW accounts, which increased $87 million, or 11%, and savings deposits, which increased $25 million, or 15%. Money market deposits were down $16 million, or 14%, however, as there is not currently a significant rate advantage for customers in money market deposits versus more liquid interest-bearing demand accounts. Total time deposits were up $2 million, or 1%, due to a $20 million increase in our deposits from the State of California that was largely offset by a $5 million reduction in wholesale brokered deposits and runoff in other customer time deposits. Management is of the opinion that a relatively high level of core customer deposits is one of the Company’s key strengths and we continue to strive for deposit retention and growth, although no assurance can be provided with regard to future core deposit increases or runoff.

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Explanation of Responses:

The scheduled maturity distribution of the Company’s time deposits at the end of 2015 was as follows:

Deposit Maturity Distribution

(dollars in thousands)

	As of December 31, 2015					
	Three months or less	Three to six months	Six to twelve months	One to three years	Over three years	Total
CDAR's	$11,613	$ 1,347	$ 898	$ 251	$ -	$14,109
Time Certificates of Deposit < $100,000	44,046	14,432	11,504	3,285	1,802	75,069
Other Time Deposits ≥ $100,000	176,371	22,097	14,213	2,447	1,616	216,744
Total	$232,030	$ 37,876	$ 26,615	$ 5,983	$ 3,418	$305,922

Other Borrowings

The Company’s non-deposit borrowings may, at any given time, include fed funds purchased from correspondent banks, borrowings from the Federal Home Loan Bank, advances from the Federal Reserve Bank, securities sold under agreement to repurchase, and/or junior subordinated debentures. The Company uses short-term FHLB advances and fed funds purchased on uncommitted lines to support liquidity needs created by seasonal deposit flows, to temporarily satisfy funding needs from increased loan demand, and for other short-term purposes. The FHLB line is committed, but the amount of available credit depends on the level of pledged collateral.

Total non-deposit interest-bearing liabilities were up $55 million, or 89%, in 2015, due primarily to increased borrowings from the Federal Home Loan Bank to facilitate our strong loan growth. Overnight FHLB borrowings were $75 million at December 31, 2015, up from $18 million at December 31, 2014, while long-term borrowings totaled $2 million at December 31, 2015 relative to $6 million at December 31, 2014. Repurchase agreements were $9 million at December 31, 2015, up from $7 million at December 31, 2014. Repurchase agreements represent “sweep accounts”, where commercial deposit balances above a specified threshold are transferred at the close of each business day into non-deposit accounts secured by investment securities. We had no fed funds purchased and no advances from the FRB on our books at December 31, 2015 or December 31, 2014. The Company had junior subordinated debentures totaling $31 million at December 31, 2015 and December 31, 2014, in the form of long-term borrowings from trust subsidiaries formed specifically to issue trust preferred securities.

The details of the Company’s short-term borrowings are presented in the table below, for the years noted:

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Short-term Borrowings

(dollars in thousands)

	Year Ended December 31,		
	2015	2014	2013
Repurchase Agreements			
Balance at December 31	$9,405	$7,251	$5,974
Average amount outstanding	8,601	5,936	2,876
Maximum amount outstanding at any month end	11,272	7,739	5,974
Average interest rate for the year	0.41 %	0.35 %	0.45 %
Fed funds purchased			
Balance at December 31	$-	$-	$-
Average amount outstanding	6	12	2
Maximum amount outstanding at any month end	335	-	-
Average interest rate for the year	N/A	N/A	N/A
FHLB advances			
Balance at December 31	$75,300	$18,200	$-
Average amount outstanding	14,697	3,502	3,497
Maximum amount outstanding at any month end	98,000	25,180	58,500
Average interest rate for the year	0.21 %	0.11 %	0.17 %

Other Non-Interest Bearing Liabilities

Other liabilities are principally comprised of accrued interest payable, other accrued but unpaid expenses, and certain clearing amounts. Other liabilities increased by $3 million, or 13%, in 2015, since a drop in our accrued liability for income taxes subsequent to tax payments and reductions in payables were more than offset by increases in other accrued liabilities.

Capital Resources

At December 31, 2015, the Company had total shareholders' equity of $190.3 million, comprised of common stock, additional paid-in capital, retained earnings, and accumulated other comprehensive income. Total shareholders' equity at the end of 2014 was $187.1 million. The net increase in total capital in 2015 came to only $3.2 million, since capital added via net earnings and stock option exercises was partially offset by stock repurchases totaling $8.0 million, dividends of $5.7 million, and a drop in accumulated other comprehensive income of $1.8 million. The decrease in accumulated other comprehensive income in 2015 represents the decline in the unrealized gain on our investment securities net of the tax effect.

The Company uses a variety of measures to evaluate its capital adequacy, including risk-based capital and leverage ratios that are calculated separately for the Company and the Bank. Management reviews these capital measurements on a quarterly basis and takes appropriate action to help ensure that they meet or surpass established internal and external guidelines. As permitted by the regulators for financial institutions that are not deemed to be “advanced approaches” institutions, the Company has elected to opt out of the Basel III requirement to include accumulated other comprehensive income in risk-based capital. The following table sets forth the Company’s and the Bank’s regulatory capital ratios as of the dates indicated:

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	December 31, 2015		December 31, 2014	
Sierra Bancorp				
Common Equity Tier 1 Capital to Risk-Weighted Assets	13.98	%	n/a	
Tier 1 Capital to Risk-weighted Assets	16.17	%	17.39	%
Total Capital to Risk-weighted Assets	17.01	%	18.44	%
Tier 1 Capital to Adjusted Average Assets ("Leverage Ratio")	12.14	%	12.99	%
Bank of the Sierra				
Common Equity Tier 1 Capital to Risk-Weighted Assets	16.01	%	n/a	
Tier 1 Capital to Risk-weighted Assets	16.01	%	17.01	%
Total Capital to Risk-weighted Assets	16.84	%	18.02	%
Tier 1 Capital to Adjusted Average Assets ("Leverage Ratio")	12.00	%	12.72	%

The drop in ratios 2015 is primarily the result of growth in risk-adjusted assets and the utilization of capital via stock repurchases. Despite declining ratios, as of the end of 2015 the Company and the Bank were both classified as “well capitalized,” the highest rating of the categories defined under the Bank Holding Company Act and the Federal Deposit Insurance Corporation Improvement Act of 1991, and its regulatory capital ratios were well above the median for peer financial institutions. We do not foresee any circumstances that would cause the Company or the Bank to be less than well capitalized, although no assurance can be given that this will not occur. For additional details on risk-based and leverage capital guidelines, requirements, and calculations and for a summary of changes to risk-based capital calculations which were recently approved by federal banking regulators, see “Item 1, Business – Supervision and Regulation – Capital Adequacy Requirements” and “Item 1, Business – Supervision and Regulation – Prompt Corrective Action Provisions” herein.

Liquidity and Market Risk Management

Liquidity

Liquidity refers to the Company’s ability to maintain cash flows that are adequate to fund operations and meet other obligations and commitments in a timely and cost-effective manner. Detailed cash flow projections are reviewed by Management on a monthly basis, with various scenarios applied to assess our ability to meet liquidity needs under adverse conditions. Liquidity ratios are also calculated and reviewed on a regular basis. While those ratios are merely indicators and are not measures of actual liquidity, they are closely monitored and we are focused on maintaining adequate liquidity resources to draw upon should unexpected needs arise.

The Company, on occasion, experiences cash needs as the result of loan growth, deposit outflows, asset purchases or liability repayments. To meet short-term needs, the Company can borrow overnight funds from other financial institutions, draw advances via Federal Home Loan Bank lines of credit, or solicit brokered deposits if deposits are not immediately obtainable from local sources. Availability on lines of credit from correspondent banks and the FHLB totaled $231 million at December 31, 2015. An additional $179 million in credit is available from the FHLB if the Company pledges sufficient additional collateral and maintains the required amount of FHLB stock. The Company is also eligible to borrow approximately $63 million at the Federal Reserve Discount Window, if necessary, based on pledged assets at December 31, 2015. Furthermore, funds can be obtained by drawing down the Company's correspondent bank deposit accounts, or by liquidating unpledged investments or other readily saleable assets. In addition, the Company can raise immediate cash for temporary needs by selling under agreement to repurchase those investments in its portfolio which are not pledged as collateral. As of December 31, 2015, unpledged debt securities plus pledged securities in excess of current pledging requirements comprised $383 million of the Company's investment balances, down slightly from $394 million at December 31, 2014. Other forms of balance sheet liquidity include but are not necessarily limited to any outstanding fed funds sold and vault cash. The Company has a higher level of actual balance sheet liquidity than might otherwise be the case, since we utilize a letter of credit from the FHLB rather than investment securities for certain pledging requirements. That letter of credit, which is backed by loans that are pledged to the FHLB by the Company, totaled $97 million at December 31, 2015. Management is of the opinion that available investments and other potentially liquid assets, along with the standby funding sources it has arranged, are more than sufficient to meet the Company's current and anticipated short-term liquidity needs.

The Company's net loans to assets and available investments to assets ratios were 63% and 22%, respectively, at December 31, 2015, as compared to internal policy guidelines of "less than 78%" and "greater than 3%." Other liquidity ratios reviewed periodically by management and the Board include net loans to total deposits and wholesale funding to total assets (including ratios and sub-limits for the various components comprising wholesale funding), which were well within policy guidelines at December 31, 2015. Despite the increase in loan balances in 2015, strong growth in core deposits and relatively high levels of potentially liquid investments have had a positive impact on our liquidity position in recent periods, although no assurance can be provided that our liquidity will continue at current robust levels.

The holding company's primary uses of funds are ordinary operating expenses, shareholder dividends and stock repurchases, and its primary source of funds is dividends from the Bank since the holding company does not conduct regular banking operations. Management anticipates that the Bank will have sufficient earnings to provide dividends to the holding company to meet its funding requirements for the foreseeable future. Both the holding company and the Bank are subject to legal and regulatory limitations on dividend payments, as outlined in Item 5(c) Dividends in this Form 10-K.

Interest Rate Risk Management

Market risk arises from changes in interest rates, exchange rates, commodity prices and equity prices. The Company does not engage in the trading of financial instruments, nor does it have exposure to currency exchange rates. Our market risk exposure is primarily that of interest rate risk, and we have established policies and procedures to monitor and limit our earnings and balance sheet exposure to changes in interest rates. The principal objective of interest rate risk management is to manage the financial components of the Company's balance sheet in a manner that will optimize the risk/reward equation for earnings and capital under a variety of interest rate scenarios.

To identify areas of potential exposure to interest rate changes, we utilize commercially available modeling software to perform earnings simulations and calculate the Company's market value of portfolio equity under varying interest rate scenarios every month. The model imports relevant information for the Company's financial instruments and incorporates management's assumptions on pricing, duration, and optionality for anticipated new volumes. Various rate scenarios consisting of key rate and yield curve projections are then applied in order to calculate the expected effect of a given interest rate change on interest income, interest expense, and the value of the Company's financial instruments. The rate projections can be shocked (an immediate and parallel change in all base rates, up or down), ramped (an incremental increase or decrease in rates over a specified time period), economic (based on current trends and econometric models) or stable (unchanged from current actual levels).

We use eight standard interest rate scenarios in conducting our rolling 12-month net interest income simulations: "stable," upward shocks of 100, 200, 300 and 400 basis points, and downward shocks of 100, 200, and 300 basis points.

Pursuant to policy guidelines, we typically attempt to limit the projected decline in net interest income relative to the stable rate scenario to no more than 5% for a 100 basis point (bp) interest rate shock, 10% for a 200 bp shock, 15% for a 300 bp shock, and 20% for a 400 bp shock. As of December 31, 2015 the Company had the following estimated net interest income sensitivity profile, without factoring in any potential negative impact on spreads resulting from competitive pressures or credit quality deterioration:

	Immediate Change in Rate						
	-300 bp	-200 bp	-100 bp	+100 bp	+200 bp	+300 bp	+400 bp
Change in Net Int. Inc. (in $000's)	$-18,357	$-12,827	$-6,784	$+1,409	$+3,234	$+5,068	$+6,432
% Change	-27.60 %	-19.29 %	-10.20 %	+2.12 %	+4.86 %	+7.62 %	+9.67 %

Our current simulations indicate that the Company has an asset-sensitive profile, meaning that net interest income increases with a parallel shift up in the yield curve but a drop in interest rates could have a negative impact. This profile is consistent with the Company's relatively large balance of less rate-sensitive non-maturity deposits and large volume of variable-rate loans, which contribute to higher net interest income in rising rate scenarios and compression in net interest income in declining rate scenarios.

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If there were an immediate and sustained downward adjustment of 100 basis points in interest rates, all else being equal, net interest income over the next twelve months would likely be around $6.784 million lower than in a stable interest rate scenario, for a negative variance of 10.20%. The unfavorable variance increases when rates drop 200 or 300 basis points, due to the fact that certain deposit rates are already relatively low (on NOW accounts and savings accounts, for example), and will hit a natural floor of close to zero while non-floored variable-rate loan yields continue to drop. This effect is exacerbated by accelerated prepayments on fixed-rate loans and mortgage-backed securities when rates decline, although rate floors on some of our variable-rate loans partially offset other negative pressures. While we view further interest rate reductions as highly unlikely, the potential percentage drop in net interest income exceeds our internal policy guidelines in declining interest rate scenarios and we will continue to monitor our interest rate risk profile and take corrective action as deemed appropriate.

Net interest income would likely improve by $1.409 million, or 2.12%, if interest rates were to increase by 100 basis points relative to a stable interest rate scenario, with the favorable variance expanding the higher interest rates rise. The initial increase in rising rate scenarios will be limited to some extent by the fact that many of our variable-rate loans are currently at rate floors, resulting in a re-pricing lag while variable rates are increasing to floored levels, but the Company still appears well-positioned to benefit from an upward shift in the yield curve.

In addition to the net interest income simulations shown above, we run stress scenarios modeling the possibility of no balance sheet growth, the potential runoff of “surge” core deposits which flowed into the Company in the most recent economic cycle, and potential unfavorable movement in deposit rates relative to yields on earning assets. Even though net interest income will naturally be lower under static growth assumptions, the changes under declining and rising rates relative to a base case of flat rates are similar to the changes noted above for our standard projections. If a certain level of non-maturity deposit runoff is assumed, projected net interest income in declining rate and flat rate scenarios does not change materially relative to standard growth projections, but the benefit we would otherwise experience in rising rate scenarios is minimized. When unfavorable rate changes on deposits are factored into the model, net interest income remains relatively flat even in rising interest rate scenarios.

The economic value (or “fair value”) of financial instruments on the Company’s balance sheet will also vary under the interest rate scenarios previously discussed. The difference between the projected fair value of the Company’s financial assets and the fair value of its financial liabilities is referred to as the economic value of equity (“EVE”), and changes in EVE under different interest rate scenarios are effectively a gauge of the Company’s longer-term exposure to interest rate risk. Fair values for financial instruments are estimated by discounting projected cash flows (principal and interest) at projected replacement interest rates for each account type, while the fair value of non-financial accounts is assumed to equal their book value for all rate scenarios. An economic value simulation is a static measure utilizing balance sheet accounts at a given point in time, and the measurement can change substantially over time as the characteristics of the Company’s balance sheet evolve and interest rate and yield curve assumptions are updated.

The change in economic value under different interest rate scenarios depends on the characteristics of each class of financial instrument, including stated interest rates or spreads relative to current or projected market-level interest rates or spreads, the likelihood of principal prepayments, whether contractual interest rates are fixed or floating, and the average remaining time to maturity. As a general rule, fixed-rate financial assets become more valuable in declining rate scenarios and less valuable in rising rate scenarios, while fixed-rate financial liabilities gain in value as interest rates rise and lose value as interest rates decline. The longer the duration of the financial instrument, the greater the impact a rate change will have on its value. In our economic value simulations, estimated prepayments are factored in for financial instruments with stated maturity dates, and decay rates for non-maturity deposits are projected based on historical patterns and management's best estimates. The table below shows estimated changes in the Company's EVE as of December 31, 2015, under different interest rate scenarios relative to a base case of current interest rates:

	Immediate Change in Rate					
	-300 bp	-200 bp	-100 bp	+100 bp	+200 bp	+300 bp
Change in EVE (in $000's)	$-90,683	$-108,499	$-68,466	$+36,954	$+63,855	$+84,663
% Change	-23.43 %	-28.03 %	-17.69 %	+9.55 %	+16.50 %	+21.87 %

The table shows that our EVE will generally deteriorate in declining rate scenarios, but should benefit from a parallel shift upward in the yield curve. While still negative relative to the base case, we see a favorable swing in EVE as interest rates drop more than 200 basis points. This is due to the relative durations of our fixed-rate assets and liabilities, combined with the optionality inherent in our balance sheet. As noted previously, however, management is of the opinion that the potential for a significant rate decline is low. We also run stress scenarios for EVE to simulate the possibility of higher loan prepayment rates, unfavorable changes in deposit rates, and higher deposit decay rates. Model results are highly sensitive to changes in assumed decay rates for non-maturity deposits, in particular.

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Item 7A. Quantitative and Qualitative Disclosures about Market Risk

The information concerning quantitative and qualitative disclosures of market risk called for by Item 305 of Regulation S-K is included as part of Item 7 above. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Market Risk Management”.

Item 8. Financial Statements and Supplementary Data

The following financial statements and independent auditors’ reports listed below are included herein:

Report of Independent Registered Public Accounting Firm

Board of Directors

Sierra Bancorp and Subsidiary

Porterville, California

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

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sierra Bancorp and Subsidiary as of December 31, 2015 and 2014, and the results of its operations, changes in its shareholders' equity, and its cash flows for each of the three years in the period ended December 31, 2015, in conformity with generally accepted accounting principles in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 11, 2016 expressed an unqualified opinion thereon.

/s/ Vavrinek, Trine, Day & Co., LLP

Rancho Cucamonga, California

March 11, 2016

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SIERRA BANCORP AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

December 31, 2015 and 2014

(dollars in thousands)

	2015	2014
ASSETS		
Cash and due from banks	$46,627	$48,405
Interest-bearing deposits in banks	1,996	1,690
Cash and cash equivalents	48,623	50,095
Securities available-for-sale	507,582	511,883
Loans and leases:		
Gross loans and leases	1,132,856	970,653
Allowance for loan and lease losses	(10,423)	(11,248)
Deferred loan and lease fees, net	2,169	1,651
Net loans and leases	1,124,602	961,056
Premises and equipment, net	21,990	21,853
Foreclosed assets	3,193	3,991
Goodwill	6,908	6,908
Other intangible assets, net	930	1,064
Company owned life insurance	44,140	42,989
Other assets	38,569	37,481
	$1,796,537	$1,637,320
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$432,251	$390,897
Interest bearing	1,032,377	975,798
Total deposits	1,464,628	1,366,695
Repurchase agreements	9,405	7,251
Short-term borrowings	75,300	18,200
Long-term borrowings	2,000	6,000
Subordinated debentures	30,928	30,928
Other liabilities	23,936	21,155
Total liabilities	1,606,197	1,450,229

Commitments and contingent liabilities (Note 12)

Shareholders' equity		
Serial Preferred stock, no par value; 10,000,000 shares authorized; none issued		
Common stock, no par value; 24,000,000 shares authorized; 13,254,088 and 13,689,181 shares issued and outstanding in 2015 and 2014 respectively	62,404	64,153
Additional paid-in capital	2,689	2,605
Retained earnings	122,701	116,026
Accumulated other comprehensive income, net of taxes of $1,846 in 2015 and $3,011 in 2014	2,546	4,307
Total shareholders' equity	190,340	187,091
	$1,796,537	$1,637,320

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

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SIERRA BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31, 2015, 2014 and 2013

(dollars in thousands, except per share data)

	2015	2014	2013
Interest and dividend income			
Loans and leases, including fees	$51,512	$44,380	$44,030
Taxable securities	8,192	7,653	4,899
Tax-exempt securities	2,953	2,936	2,737
Dividend income on securities	19	90	17
Federal funds sold and other	31	62	102
Total interest income	62,707	55,121	51,785
Interest expense			
Deposits	1,785	2,064	2,455
Short-term borrowings	66	25	19
Long-term borrowings	13	4	33
Subordinated debentures	717	703	714
Total interest expense	2,581	2,796	3,221
Net interest income	60,126	52,325	48,564
Provision for loan and lease losses	-	350	4,350
Net interest income after provision for loan and lease losses	60,126	51,975	44,214
Non-interest income			
Service charges on deposits	9,399	8,275	9,022
Gain on sale of loans	6	3	129
Credit card fees	463	451	462
Checkcard fees	4,234	3,908	3,749
Net gains on sale of securities available-for-sale	666	667	6
Increase in cash surrender value of life insurance	907	1,278	1,787
Other income	2,040	1,249	1,908
Total non-interest income	17,715	15,831	17,063
Non-interest expense			
Salaries and employee benefits	24,871	22,926	21,920
Occupancy and equipment	6,899	6,344	6,274
Acquisition costs	101	2,070	-
Other	18,832	15,035	16,621
Total non-interest expense	50,703	46,375	44,815
Income before income taxes	27,138	21,431	16,462

Provision for income taxes	9,071	6,191	3,093
Net income	$18,067	$15,240	$13,369
Earnings per share			
Basic	$1.34	$1.09	$0.94
Diluted	$1.33	$1.08	$0.94
Weighted average shares outstanding, basic	13,460,605	14,001,958	14,155,927
Weighted average shares outstanding, diluted	13,585,110	14,136,486	14,290,150

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

SIERRA BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended December 31, 2015, 2014 and 2013

(dollars in thousands)

	2015			2014			2013		
Net income	$	18,067		$	15,240		$	13,369	
Other comprehensive income (loss), before tax:									
Unrealized gains on securities:									
Unrealized holding gain (loss) arising during period		(2,224	)		7,257			(5,588	)
Reclassification adjustment for gain [1] included in net income		(666	)		(667	)		(6	)
Other comprehensive income (loss), before tax		(2,890	)		6,590			(5,594	)
Income tax (expense) benefit related to items of other comprehensive income		1,129			(2,712	)		2,303	
Total other comprehensive income (loss), net of tax		(1,761	)		3,878			(3,291	)
Comprehensive income	$	16,306		$	19,118		$	10,078	

(1) Amounts are included in net gains on securities available-for-sale on the Consolidated Statements of Income in non-interest income. Income tax expense associated with the reclassification adjustment for the years ended 2015, 2014 and 2013 was $280 thousand, $274 thousand and $2 thousand respectively.

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

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SIERRA BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Three Years Ended December 31, 2015

(dollars in thousands, except per share data)

	Common Stock					
	Shares	Amount	**Additional Paid In Capital**	**Retained Earnings**	**Accumulated Other Comprehensive Income**	**Shareholders' Equity**
Balance, January 1, 2013	14,106,959	$64,384	$ 2,660	$ 103,128	$ 3,720	$ 173,892
Net Income				13,369		13,369
Other comprehensive loss, net of tax					(3,291)	(3,291)
Exercise of stock options and related tax benefit	110,240	1,396	(280)			1,116
Stock compensation costs			268			268
Cash dividends - $.26 per share				(3,680)		(3,680)
Balance, December 31, 2013	14,217,199	65,780	2,648	112,817	429	181,674
Net Income				15,240		15,240
Other comprehensive income, net of tax					3,878	3,878
Exercise of stock options and related tax benefit	95,330	1,300	(224)			1,076
Stock compensation costs			181			181
Stock repurchase	(623,348)	(2,927)		(7,256)		(10,183)
Cash dividends - $.34 per share				(4,775)		(4,775)
Balance, December 31, 2014	13,689,181	64,153	2,605	116,026	4,307	187,091
Net Income				18,067		18,067
Other comprehensive loss, net of tax					(1,761)	(1,761)
	37,240	477	49			526

Exercise of stock options and related tax benefit						
Stock compensation costs			35			35
Stock repurchase	(472,333)	(2,226)		(5,730)		(7,956)
Cash dividends - $.42 per share				(5,662)		(5,662)
Balance, December 31, 2015	13,254,088	$62,404	$ 2,689	$ 122,701	$ 2,546	$ 190,340

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

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SIERRA BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2015, 2014, and 2013

(dollars in thousands)

	2015	2014	2013
Cash flows from operating activities:			
Net income	$18,067	$15,240	$13,369
Adjustments to reconcile net income to net cash provided by operating activities:			
Gain on investment of securities	(666)	(667)	(6)
Gain on sales of loans	(6)	(3)	(129)
Loss (gain) on disposal of fixed assets	62	(4)	(15)
(Gain) loss on sale of foreclosed assets	(259)	(2,253)	223
Writedown of foreclosed assets	221	452	730
Share-based compensation expense	35	181	268
Provision for loan losses	-	350	4,350
Depreciation and amortization	2,272	2,107	2,131
Net amortization on securities premiums and discounts	6,932	6,607	8,177
Decrease in unearned net loan fees	518	129	366
Increase in cash surrender value of life insurance policies	(1,151)	(1,475)	(1,417)
Proceeds from sales of loans	323	108	5,459
Originations of loans held for sale	(317)	-	(5,225)
Decrease in interest receivable and other assets	1,219	5,884	2,225
Increase in other liabilities	758	3,453	1,514
Deferred income tax provision (benefit)	1,629	(1,151)	2,360
Excess tax provision (benefit) from equity based compensation	146	(224)	(280)
Net cash provided by operating activities	29,783	28,734	34,100
Cash flows from investing activities:			
Maturities of securities available for sale	580	1,620	1,724
Proceeds from sales/calls of securities available for sale	39,831	29,452	4,135
Purchases of securities available for sale	(136,459)	(150,515)	(160,251)
Principal paydowns on securities available for sale	91,193	77,442	95,772
Net (purchases) redemption of FHLB stock	(504)	(190)	438
(Increase) decrease in loans receivable, net	(165,061)	(107,734)	64,868
Purchases of premises and equipment, net	(2,530)	(2,379)	(667)
Proceeds from sales of foreclosed assets	1,833	6,854	15,023
Proceeds from sales of fixed assets	59	4	-
Cash acquired in bank acquisition	-	514	-

Net cash used in investing activities	(171,058)	(144,932)	21,042
Cash flows from financing activities:			
Increase in deposits	97,933	84,244	145
Increase (decrease) in borrowed funds	53,100	16,200	(41,650)
Increase in repurchase agreements	2,154	1,277	4,555
Cash dividends paid	(5,662)	(4,775)	(3,680)
Repurchases of common stock	(7,956)	(10,183)	-
Stock options exercised	380	1,300	1,396
Excess tax (benefit) provision from equity based compensation	(146)	224	280
Net cash provided by financing activities	139,803	88,287	(38,954)
(Decrease) increase in cash and due from banks	(1,472)	(27,911)	16,188
Cash and cash equivalents, beginning of year	50,095	78,006	61,818
Cash and cash equivalents, end of year	$48,623	$50,095	$78,006

(Continued)

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SIERRA BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Continued)

Years Ended December 31, 2015, 2014 and 2013

(dollars in thousands)

Supplemental disclosure of cash flow information:

Cash paid during the year for:			
Interest	$1,957	$2,845	$3,340
Income taxes	$6,390	$1,800	$-
Non-cash investing activities			
Real estate acquired through foreclosure	$1,004	$842	$4,990
Change in unrealized net (losses) gains on			
Securities available-for-sale	$(2,890)	$6,590	$(5,594)
Assets acquired (liabilities assumed) in bank acquisition:			
Cash and cash equivalents	$-	$15,852	$-
Securities	$-	$44,187	$-
Federal Home Loan Bank stock	$-	$860	$-
Loans	$-	$61,573	$-
Premises and equipment	$-	$1,188	$-
Core deposit intangibles	$-	$1,075	$-
Goodwill	$-	$1,364	$-
Other assets	$-	$5,719	$-
Deposits	$-	$(108,272)	$-
Federal Home Loan Bank advances	$-	$(8,000)	$-
Other liabilities	$-	$(208)	$-

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

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. THE BUSINESS OF SIERRA BANCORP

Sierra Bancorp (the “Company”) is a California corporation registered as a bank holding company under the Bank Holding Company Act of 1956, as amended, and is headquartered in Porterville, California. The Company was incorporated in November 2000 and acquired all of the outstanding shares of Bank of the Sierra (the “Bank”) in August 2001. The Company’s principal subsidiary is the Bank, and the Company exists primarily for the purpose of holding the stock of the Bank and of such other subsidiaries it may acquire or establish. The Company’s only other direct subsidiaries are Sierra Statutory Trust II, which was formed in March 2004 solely to facilitate the issuance of capital trust pass-through securities, and Sierra Capital Trust III, which was formed in June 2006 for the same purpose.

The Bank operates twenty-eight full service branch offices, an online branch, a real estate industries group, an agricultural credit division, an SBA lending unit, and one loan production office. The Bank’s deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to applicable legal limits. The Bank maintains a diversified loan portfolio comprised of agricultural, commercial, consumer, real estate construction and mortgage loans. Loans are made primarily within the market area of the South Central San Joaquin Valley of California, specifically, Tulare, Fresno, Kern, Kings, and Madera counties, however, the Bank recently expanded into the Southern California corridor stretching from Santa Paula to Santa Clarita in the counties of Ventura and Los Angeles. These areas have diverse economies with principal industries being agriculture, real estate and light manufacturing.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of the Company and the consolidated accounts of its wholly-owned subsidiary, Bank of the Sierra. All significant intercompany balances and transactions have been eliminated. Certain reclassifications have been made to prior years' balances to conform to classifications used in 2015. The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (U.S. GAAP) and prevailing practices within the banking industry.

In accordance with U.S. GAAP, the Company’s investments in Sierra Statutory Trust II and Sierra Capital Trust III are not consolidated and are accounted for under the equity method and included in other assets on the consolidated balance sheet. The subordinated debentures issued and guaranteed by the Company and held by the trusts are reflected on the Company’s consolidated balance sheet.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ.

Material estimates that are particularly susceptible to significant changes in the near-term relate to the determination of the allowance for loan and lease losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowances for loan and lease losses and other real estate, management obtains independent appraisals for significant properties, evaluates the overall loan portfolio characteristics and delinquencies and monitors economic conditions.

Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash and deposits with other financial institutions with maturities fewer than 90 days, and federal funds sold. Net cash flows are reported for customer loan and deposit transactions, interest bearing deposits in other financial institutions, and fed funds purchased and repurchase agreements.

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Securities

Debt securities may be classified as held to maturity and carried at amortized cost when management has the positive ability and intent to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums or discounts on securities are amortized on the level-yield method without anticipating prepayments. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. 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 currently classified as “available for sale” to allow maximum flexibility with regard to interest rate risk and liquidity management.

Management evaluates securities for other-than-temporary impairment (“OTTI”) on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of the impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Loans Held for Sale

The Company periodically originates loans intended to be sold on the secondary market. Loans originated and intended for sale in the secondary market are carried at cost which approximates fair value since these loans are typically sold shortly after origination. The loan's cost basis includes unearned deferred fees and costs, and premiums and discounts. If loans held for sale remain on our books for an extended period of time the fair value of those loans is determined using quoted secondary market prices. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Loans held for sale by the Company consist entirely of residential real estate loans. Loans classified as held for sale are disclosed in Note 4 of these Consolidated Financial Statements.

Gains and losses on sales of loans are recognized at the time of sale and are calculated based on the difference between the selling price and the allocated book value of loans sold. Book value allocations are determined in accordance with U.S. GAAP. Any inherent risk of loss on loans sold is transferred to the buyer at the date of sale.

The Company has issued various representations and warranties associated with the sale of loans. These representations and warranties may require the Company to repurchase loans with underwriting deficiencies as defined per the applicable sales agreements and certain past due loans within 90 days of the sale. The Company did not experience losses during the years ended December 31, 2015, 2014, or 2013 regarding these representations and warranties.

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans and Leases (Financing Receivables)

Our credit quality classifications of Loans and Leases include Pass, Special Mention, Substandard and Impaired. These classifications are defined in Note 4 (Loans and Leases) to our consolidated financial statements.

Loans and leases that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs, purchase premiums and discounts, write-downs, and an allowance for loan and lease losses. Loan and lease origination fees, net of certain deferred origination costs, and purchase premiums and discounts are recognized in interest income as an adjustment to yield of the related loans and leases over the contractual life of the loan using both the effective interest and straight line methods without anticipating prepayments.

Interest income for all performing loans, regardless of classification (Pass, Special Mention, Substandard and Impaired), is recognized on an accrual basis, with interest accrued daily. Costs associated with successful loan originations are netted from loan origination fees, with the net amount (net deferred loan fees) amortized over the contractual life of the loan in interest income. If a loan has scheduled periodic payments, the amortization of the net deferred loan fee is calculated using the effective interest method over the contractual life of the loan. If the loan does not have scheduled payments, such as a line of credit, the net deferred loan fee is recognized as interest income on a straight line basis over the contractual life of the loan. Fees received for loan commitments are recognized as interest income over the term of the commitment. When loans are repaid, any remaining unamortized balances of deferred fees and costs are accounted for through interest income.

Generally, the Company places a loans or lease on nonaccrual status and ceases recognizing interest income when it has become delinquent more than 90 days and/or when Management determines that the repayment of principal and collection of interest is unlikely. The Company may decide that it is appropriate to continue to accrue interest on certain loans more than 90 days delinquent if they are well-secured by collateral and collection is in process. When a loan is placed on nonaccrual status, any accrued but uncollected interest for the loan is reversed out of interest income in the period in which the loan's status changed. For loans with an interest reserve, i.e., where loan proceeds are advanced to the borrower to make interest payments, all interest recognized from the inception of the loan is reversed when the loan is placed on non-accrual. Once a loan is on non-accrual status subsequent payments received from the customer are applied to principal, and no further interest income is recognized until the principal has been paid in full or until circumstances have changed such that payments are again consistently received as contractually required. Generally, loans and leases are not restored to accrual status until the obligation is brought current and has performed in accordance with the contractual terms for a reasonable period of time, and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

Impaired loans are classified as either nonaccrual or accrual, depending on individual circumstances regarding the collectability of interest and principal according to the contractual terms.

Purchased Credit Impaired Loans

The Company purchases individual loans and groups of loans, some of which show evidence of credit deterioration since origination. These purchased credit impaired (“PCI”) loans are recorded at the amount paid, since there is no carryover of the seller’s allowance for loan losses. After acquisition, losses are recognized by an increase in the allowance for loan losses.

Such PCI loans are accounted for individually or aggregated into pools of loans based on common risk characteristics. The Company estimates the amount and timing of expected cash flows for the loan or pool, and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan or pool (accretable yield). The excess of the loan’s or pool’s contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Over the life of the loan or pool, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded as a provision for loan and lease losses. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income

Loans Modified in a Troubled Debt Restructuring

Loans are considered to have been modified in a troubled debt restructuring ("TDR") when due to a borrower's financial difficulties the Company makes certain concessions to the borrower that it would not otherwise consider. Modifications may include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of collateral. Generally, a non-accrual loan that has been modified in a TDR remains on non-accrual status for a period of six months to demonstrate that the borrower is able to meet the terms of the modified loan. However, performance prior to the modification, or significant events that coincide with the modification, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of loan modification or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains on non-accrual status.

A TDR is generally considered to be in default when it appears likely that the customer will not be able to repay all principal and interest pursuant to the terms of the restructured agreement.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses is maintained at a level which, in management's judgment, is adequate to absorb loan and lease losses inherent in the loan and lease portfolio. The allowance for loan and lease losses is increased by a provision for loan and lease losses, which is charged to expense, and reduced by principal charge-offs, net of recoveries. The amount of the allowance is based on management's evaluation of the collectability of the loan and lease portfolio, changes in its risk profile, credit concentrations, historical trends, and economic conditions. This evaluation also considers the balance of impaired loans and leases. A loan or lease is impaired when it is probable that the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan or lease agreement. The impairment on certain individually identified loans or leases is measured based on the present value of expected future cash flows discounted at the original effective interest rate of the loan or lease. As a practical expedient, impairment may be measured based on the loan’s or lease’s observable market price or the fair value of collateral if the loan or lease is collateral dependent. The amount of impairment, if any, is recorded through the provision for loan and lease losses and is added to the allowance for loan and lease losses, with any changes over time recognized as additional bad debt expense in our provision for loan losses. Impaired loans with homogenous characteristics, such as one-to-four family residential mortgages and consumer installment loans, may be subjected to a collective evaluation for impairment, considering delinquency and repossession statistics, historical loss experience, and other factors.

General reserves cover non-impaired loans and are based on historical net loss rates for each portfolio segment by call report code, adjusted for the effects of qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio segment’s historical loss experience. Qualitative factors include consideration of the following: changes in lending policies and procedures; changes in international, national, regional, and local economic and business conditions and developments; changes in nature and volume of the portfolio; changes in the experience, ability and depth of lending management and staff; changes in the volume and severity of past due, nonaccrual and other adversely graded loans; changes in quality of the loan review system; changes in the value of the underlying collateral for collateral-dependent loans; concentrations of credit; and the effect of the other external factors such as competition and legal and regulatory requirements.

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Most of the Company's business activity is with customers located in California within the Southern Central San Joaquin Valley and the corridor stretching between Santa Paula and Santa Clarita, therefore the Company's exposure to credit risk is significantly affected by changes in the economy in those regions. The Company considers this concentration of credit risk when assessing and assigning qualitative factors in the allowance for loan losses. Portfolio segments identified by the Company include Direct Financing leases, Agricultural, Commercial and Industrial, Real Estate, Small Business Administration, and Consumer loans. Relevant risk characteristics for these portfolio segments generally include debt service coverage, loan-to-value ratios and financial performance on non-consumer loans; and credit scores, debt-to-income ratios, collateral type and loan-to-value ratios for consumer loans.

Though management believes the allowance for loan and lease losses to be adequate, ultimate losses may vary from their estimates. However, estimates are reviewed periodically, and as adjustments become necessary they are reported in earnings during the periods they become known. In addition, the FDIC and the California Department of Business Oversight, as an integral part of their examination processes, review the allowance for loan and lease losses. These agencies may require additions to the allowance for loan and lease losses based on their judgment about information available at the time of their examinations.

Reserve for Off-Balance Sheet Commitments

In addition to the exposure to credit loss from outstanding loans, the Company is also exposed to credit loss from certain off-balance sheet commitments such as unused commitments from revolving lines of credit, mortgage warehouse lines of credit, unused commitments on construction loans and commercial and standby letters of credit. Because the available funds have not yet been disbursed on these commitments the estimated losses are not included in the calculation of ALLL. The reserve for off-balance sheet commitments is an estimated loss contingency which is included in other liabilities on the Consolidated Balance Sheets. The adjustments to the reserve for off-balance sheet commitments are reported as a noninterest expense. This reserve is for estimated losses that could occur when the Company is contractually obligated to make a payment under these instruments and must seek repayment from a party that may not be as financially sound in the current period as it was when the commitment was originally made.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The useful lives of premises range between twenty-five to thirty-nine years. The useful lives of furniture, fixtures and equipment range between three to twenty years. Leasehold improvements are amortized over the life of the asset or the term of the related lease, whichever is shorter. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred.

Impairment of long-lived assets is evaluated by management based upon an event or changes in circumstances surrounding the underlying assets which indicate long-lived assets may be impaired.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Foreclosed Assets

Foreclosed assets include real estate and other property acquired in full or partial settlement of loan obligations. Upon acquisition, any excess of the recorded investment in the loan balance over the appraised fair market value, net of estimated selling costs, is charged against the allowance for loan and lease losses. A valuation allowance for losses on foreclosed assets is maintained to provide for temporary declines in value. The allowance is established through a provision for losses on foreclosed assets which is included in other non-interest expense. Subsequent gains or losses on sales or write-downs resulting from permanent impairments are recorded in other non-interest income or expense as incurred. Operating costs after acquisition are expensed.

The Company had no foreclosed residential real estate properties recorded at December 31, 2015, as a result of obtaining physical possession of the property. At December 31, 2015, the recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceeds are in process is $709,000.

Goodwill and Other Intangible Assets

The Company acquired Sierra National Bank in 2000. Goodwill resulting from business combinations prior to January 1, 2009 represents the amount by which the purchase price exceeded the fair value of the net assets.

The Company acquired Santa Clara Valley Bank in 2014. Goodwill resulting from business combinations after January 1, 2009 is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date.

Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually or more frequently if events and circumstances exist which indicate that an impairment test should be performed. The Company selected December 31, 2015 as the date to perform the annual impairment test for 2015. Goodwill is the only intangible asset with an indefinite life on our balance sheet. There was no impairment recognized for the years ended December 31, 2015, 2014, and 2013.

Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. The Company's other intangible assets consist solely of core deposit intangible assets arising from the acquisition of Santa Clara Valley Bank, which are being amortized on a straight line basis over eight years.

Loan Commitments and Related Financial Instruments

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded. Details regarding these commitments and financial instruments are discussed in detail in Note 12 to our consolidated financial statements.

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

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

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax basis of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely to be realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. We have determined that as of December 31, 2015 all tax positions taken to date are highly certain and, accordingly, no accounting adjustment has been made to the financial statements.

The Company recognizes interest and penalties related to uncertain tax positions as part of income tax expense.

Salary Continuation Agreements and Directors' Retirement Plan

The Company has entered into agreements to provide members of the Board of Directors and certain key executives, or their designated beneficiaries, with annual benefits for up to fifteen years after retirement or death. The Company accrues for these future benefits from the effective date of the plan until the director's or executive's expected retirement date in a systematic and rational manner. At the consolidated balance sheet date, the amount of accrued benefits equals the then present value of the benefits expected to be provided to the director or employee, any beneficiaries, and covered dependents in exchange for the director's or employee's services to that date.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale, net of an adjustment for the effects of realized gains and losses and any applicable tax. Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income that historically has not been recognized in the calculation of net income. Unrealized gains and losses on the Company's available for sale securities are included in other comprehensive income after adjusting for the effects of realized gains and losses. Total comprehensive income and the components of accumulated other comprehensive income (loss) are presented in the consolidated statements of comprehensive income.

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Stock-Based Compensation

At December 31, 2015, the Company had one stock-based compensation plan, the Sierra Bancorp 2007 Stock Incentive Plan (the “2007 Plan”), which was adopted by the Company’s Board of Directors on March 15, 2007 and approved by the Company’s shareholders on May 23, 2007. The 2007 Plan originally covered 1,500,000 shares of the Company’s authorized but unissued common stock, subject to adjustment for stock splits and dividends, and provides for the issuance of both “incentive” and “nonqualified” stock options to salaried officers and employees, and of “nonqualified” stock options to non-employee directors. The 2007 Plan also provides for the issuance of restricted stock awards to these same classes of eligible participants. We have not issued, nor do we currently have plans to issue, restricted stock awards. The 2007 plan supersedes the Company’s 1998 Stock Option plan (“1998 Plan”) which was terminated. The outstanding options issued under the 1998 Plan were not affected by this termination**.**

Compensation cost and director’s expense is recognized for stock options issued to employees and directors and is recognized over the required service period, generally defined as the vesting period. The Company is using the Black-Scholes model to value stock options. The “multiple option” approach is used to allocate the resulting valuation to actual expense for current period. Expected volatility is based on historical volatility of the Company’s common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding subsequent to vesting, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. The fair value of each option is estimated on the date of grant using the following assumptions:

	Years Ended December 31,				
	2015		2014		2013 [1]
Dividend yield	2.18	%	2.08	%	N/A
Expected Volatility	26.45	%	25.01	%	N/A
Risk-free interest rate	1.02	%	1.00	%	N/A
Expected option life	4.0 years		4.0 years		N/A

[1] No stock options were issued in 2013.

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements

In January 2014, the FASB issued 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, and early adoption is permitted. The Company adopted ASU 2014-01 in the first quarter of 2015, however we are continuing to account for our low-income housing tax credit investments using the equity method therefore there was no impact on our income statement or balance sheet, but our disclosures with regard to low-income housing tax credit investments were updated to reflect the new requirements.

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. ASU 2014-04 did not have any impact on the Company's financial statements or operations upon adoption.

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.

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In May 2014, the FASB issued Accounting Standards Update (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 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is not permitted. The Company is currently evaluating the potential effects of this 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 which amended existing guidance related to the accounting for share-based payments when the terms of an award provide that a performance target could be achieved after the requisite service period. These amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718, Compensation – Stock Compensation, as it relates to awards with performance conditions that affect vesting to account for such awards. 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In August 2014, the FASB issued ASU 2014-14 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. ASU 2014-14 did not have any impact upon the Company’s financial statements or operations upon adoption, and is not expected to have any impact in future periods.

On January 5, 2016, the FASB issued Accounting Standards Update 2016-01, Financial Instruments–Overall: Recognition and Measurement of Financial Assets and Financial Liabilities. Changes made to the current measurement model primarily affect the accounting for equity securities with readily determinable fair values, where changes in fair value will impact earnings instead of other comprehensive income. The accounting for other financial instruments, such as loans, investments in debt securities, and financial liabilities is largely unchanged. The Update also changes the presentation and disclosure requirements for financial instruments including a requirement that public business entities use exit price when measuring the fair value of financial instruments measured at amortized cost for disclosure purposes. This Update is generally effective for public business entities in fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We are currently evaluating the effects of ASU 2016-01 on our financial statements and disclosures.

On February 25, 2016, the FASB issued Accounting Standards Update 2016-02, Leases (Topic 842). The new standard is being issued to increase the transparency and comparability around lease obligations. Previously unrecorded off-balance sheet obligations will now be brought more prominently to light by presenting lease liabilities on the face of the balance sheet, accompanied by enhanced qualitative and quantitative disclosures in the notes to the financial statements. This Update is generally effective for public business entities in fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the effects of ASU 2016-02 on its financial statements and disclosures.

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. SECURITIES AVAILABLE-FOR-SALE

The amortized cost and fair value of the securities available-for-sale are as follows (dollars in thousands):

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
US Government Agencies	$ 28,801	$ 303	$ (62)	$ 29,042
Mortgage-backed securities	374,683	2,440	(2,062)	375,061
State and political subdivisions	99,093	3,146	(56)	102,183
Equity securities	575	721	-	1,296
Total securities	$ 503,152	$ 6,610	$ (2,180)	$ 507,582

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

For the years ended December 31, 2015, 2014, and 2013, proceeds from sales of securities available-for-sale were $31.2 million, $26.7 million, and $700 thousand, respectively. Gains and losses on the sale of investment securities are recorded on the trade date and are determined using the specific identification method.

Gross gains and losses from the sales and calls of securities for the years ended were as follows (dollars in thousands):

	December 31,		
	2015	2014	2013
Gross gains on sales and calls of securities	$894	$739	$ 6
Gross losses on sales and calls of securities	(228)	(72)	-
Net gains on sales and calls of securities	$666	$667	$ 6

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. SECURITIES AVAILABLE-FOR-SALE (Continued)

At December 31, 2015 and 2014, the Company had 175 and 134 securities with unrealized gross losses, respectively. Information pertaining to these securities aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows (dollars in thousands):

	December 31, 2015			
	Less than twelve months		Twelve months or longer	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
US Government Agencies	$(62)	$10,329	$ -	$ -
Mortgage-backed securities	(1,608)	187,734	(454)	35,511
State and political subdivisions	(17)	3,409	(39)	3,847
Equity securities	-	-	-	-
Total	$(1,687)	$201,472	$ (493)	$ 39,358

	December 31, 2014			
	Less than twelve months		Twelve months or longer	
	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
Equity securities	-	-	-	-
Total	$(618)	$ 95,227	$ (801)	$ 61,027

The Company has reviewed all sectors and securities in the portfolio for impairment. During the year ended December 31, 2015 the Company realized gains through earnings from the sale of 49 debt securities for $388,000 and two equity positions for $506,000. The securities were sold with 42 other debt securities, for which a $228,000 loss was realized, to improve the structure in the portfolio while reducing administrative costs. During the year ended December 31, 2014, the Company realized gains of $739,000 and losses of $72,000 from the sale of 66 debt securities and one equity position which were sold to improve the credit quality of the portfolio by minimizing securities on our Municipal Bond Watch List.

The Company has concluded as of December 31, 2015 that all remaining securities, currently in an unrealized loss position, are not other-than-temporarily-impaired. This assessment was based on the following factors: 1) the Company has the ability to hold the security, 2) the Company does not intend to sell the security, 3) the Company does not anticipate it will be required to sell the security before recovery, 4) and the Company expects to eventually recover the entire amortized cost basis of the security.

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. SECURITIES AVAILABLE-FOR-SALE (Continued)

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

	Amortized Cost	Fair Value
	(dollars in thousands)	
Maturing within one year	$ 3,657	$ 3,706
Maturing after one year through five years	242,719	244,733
Maturing after five years through ten years	50,144	51,308
Maturing after ten years	50,413	51,671
Securities not due at a single maturity date:		
U.S Government agencies collateralized by mortgage obligations	155,644	154,868
Other securities	575	1,296
	$ 503,152	$ 507,582

Securities available-for-sale with amortized costs totaling $178,472,000 and estimated fair values totaling $180,209,000 were pledged to secure other contractual obligations and short-term borrowing arrangements at December 31, 2015 (see Note 9).

Securities available-for-sale with amortized costs totaling $137,160,000 and estimated fair values totaling $140,611,000 were pledged to secure public deposits, other contractual obligations and short-term borrowing arrangements at December 31, 2014 (see Note 9).

At December 31, 2015, the Company’s investment portfolio included securities issued by 231 different government municipalities and agencies located within 27 states with a fair value of $102.2 million. The largest exposure to any single municipality or agency was $2.5 million (fair value) in six bonds issued for the renovation, modernization and construction of various school facilities by the Lindsay Unified School District, to be repaid by future tax revenues.

The Company's investments in bonds issued by states, municipalities and political subdivisions are evaluated in accordance with Supervision and Regulation Letter 12-15 (SR 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.

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. SECURITIES AVAILABLE-FOR-SALE (Continued)

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 (dollars in thousands):

	December 31, 2015		December 31, 2014	
General obligation bonds	Amortized Cost	Fair Value	Amortized Cost	Fair Value
State of Issuance:				
California	$20,473	$21,642	$20,078	$21,288
Texas	16,575	16,954	14,489	14,675
Illinois	9,997	10,191	8,272	8,394
Ohio	7,610	7,748	7,456	7,555
Washington	5,905	6,081	5,966	6,126
Arizona	2,039	2,108	2,070	2,156
Utah	953	990	956	984
Other (19 states)	20,334	20,848	19,183	19,676
Total General Obligation Bonds	83,886	86,562	78,470	80,854
Revenue bonds				
State of Issuance:				
Utah	4,434	4,519	3,769	3,834
Texas	3,732	3,863	3,273	3,387
Washington	1,791	1,827	1,167	1,197
California	1,002	1,028	2,174	2,233
Ohio	318	319	321	332
Arizona	-	-	3,710	3,777
Other (7 states)	3,930	4,065	5,172	5,335
Total Revenue Bonds	15,207	15,621	19,586	20,095
Total Obligations of States and Political Subdivisions	$99,093	$102,183	$98,056	$100,949

The following table summarizes the amortized cost and fair value of revenue bonds in the Company's investment securities portfolio at the indicated dates, identifying the revenue source of repayment for our largest source concentrations (dollar in thousands):

Revenue bonds	December 31, 2015 Amortized Cost	Fair Value	December 31, 2014 Amortized Cost	Fair Value
Revenue Source:				
Water	$ 3,942	$ 4,052	$ 7,100	$ 7,278
College & University	2,975	3,103	2,723	2,834
Sales Tax	2,630	2,663	2,361	2,405
Lease	2,040	2,100	1,356	1,362
Electric & Power	679	691	1,880	1,914
Other (9 sources)	2,941	3,012	4,166	4,302
Total Revenue Bonds	$ 15,207	$ 15,621	$ 19,586	$ 20,095

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. LOANS AND LEASES

The composition of the loan and lease portfolio is as follows (dollars in thousands):

	December 31, 2015	2014
Real estate:		
Secured by residential, commercial and professional office properties, including construction and development	$421,174	$370,639
Secured by residential properties	223,752	188,552
Secured by farm land	133,182	145,039
Total real estate loans	778,108	704,230
Agricultural	46,237	27,746
Commercial and industrial	113,207	113,771
Mortgage warehouse lines	180,355	106,021
Consumer	14,949	18,885
Total loans	1,132,856	970,653
Deferred loan and lease origination cost, net	2,169	1,651
Allowance for loan and lease losses	(10,423)	(11,248)
Loans, net	$1,124,602	$961,056

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 and qualify the associated credit risk. Loans classified as “loss” are immediately charged-off. The Company uses the following definitions of risk classifications:

Pass – Loans listed as pass include larger non-homogeneous loans not meeting the risk rating definitions below and smaller, homogeneous loans not assessed on an individual basis.

Special Mention – Loans classified as special mention have the potential weakness that deserves management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution’s credit position and some future date.

Substandard – Loans classified as substandard are those loans with clear and well-defined weaknesses such as a highly leveraged position, unfavorable financial operating results and/or trends, or uncertain repayment sources or poor financial condition, which may jeopardize ultimate recoverability of the debt.

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. Additionally, all loans classified as troubled debt restructurings are considered impaired.

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. LOANS AND LEASES (Continued)

Credit quality classifications as of December 31, 2015 were as follows (dollars in thousands):

	Pass	Special Mention	Substandard	Impaired	Total
Real Estate:					
1-4 family residential construction	$13,784	$ 1,157	$ -	$ -	$14,941
Other Construction/Land	35,901	135	-	1,323	37,359
1-4 family - closed-end	127,972	2,498	387	6,499	137,356
Equity Lines	39,966	199	957	3,111	44,233
Multi-family residential	26,178	-	-	1,044	27,222
Commercial real estate owner occupied	196,211	12,075	7,322	3,100	218,708
Commercial real estate Non-owner occupied	155,223	4,505	170	5,209	165,107
Farmland	130,285	1,563	724	610	133,182
Total Real Estate	725,520	22,132	9,560	20,896	778,108
Agricultural	46,197	40	-	-	46,237
Commercial and Industrial	108,931	933	755	2,588	113,207
Mortgage warehouse lines	180,355	-	-	-	180,355
Consumer loans	12,718	178	16	2,037	14,949
Total Gross Loans and Leases	$1,073,721	$ 23,283	$ 10,331	$25,521	$1,132,856

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. LOANS AND LEASES (Continued)

Credit quality classifications as of December 31, 2014 were as follows (dollars in thousands):

	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 lines	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

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. LOANS AND LEASES (Continued)

Loans may or may not be collateralized, and collection efforts are continuously pursued. Loans or leases may be restructured by management when a borrower has experienced some change in financial status causing an inability to meet the original repayment terms and where the Company believes the borrower will eventually overcome those circumstances and make full restitution. Loans and leases are charged off when they are deemed to be uncollectible, while recoveries are generally recorded only when cash payments are received subsequent to the charge-off.

The following tables present the activity in the allowance for loan losses and the recorded investment in loans and impairment method by portfolio segment for each of the years ending December 31, 2015, 2014, and 2013 (dollars in thousands):

	Real Estate	Agricultural	Commercial and Industrial [(1)]	Consumer	Unallocated	Total
Allowance for credit losses:						
Balance, December 31, 2012	$ 8,034	$ 258	$ 3,467	$ 2,114	$ -	$ 13,873
Charge-offs	(4,205)	(473)	(1,668)	(1,917)	-	(8,263)
Recoveries	618	-	802	297	-	1,717
Provision	1,097	1,193	1,186	623	251	4,350
Balance, December 31, 2013	5,544	978	3,787	1,117	251	11,677
Charge-offs	(1,629)	(124)	(625)	(1,837)	-	(4,215)
Recoveries	1,913	6	801	716	-	3,436
Provision	415	126	(2,019)	1,769	59	350
Balance, December 31, 2014	6,243	986	1,944	1,765	310	11,248
Charge-offs	(706)	-	(395)	(1,739)	-	(2,840)
Recoveries	751	81	225	958	-	2,015
Provision	(1,505)	(345)	759	279	812	-
Balance, December 31, 2015	$ 4,783	$ 722	$ 2,533	$ 1,263	$ 1,122	$ 10,423

(1) Includes mortgage warehouse lines

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. LOANS AND LEASES (Continued)

Loans evaluated for impairment:

	December 31, 2015		December 31, 2014		December 31, 2013	
	Individually	Collectively	Individually	Collectively	Individually	Collectively
Real estate	$20,896	$757,212	$30,620	$673,610	$47,010	$530,829
Agricultural	-	46,237	-	27,746	470	24,710
Commercial and Industrial (1)	2,588	290,974	2,916	216,876	5,444	171,243
Consumer	2,037	12,912	2,888	15,997	3,463	20,073
Total loans	$25,521	$1,107,335	$36,424	$934,229	$56,387	$746,855

(1) Includes mortgage warehouse lines

Reserves based on method of evaluation for impairment:

	December 31, 2015		December 31, 2014		December 31, 2013	
	Specific	General	Specific	General	Specific	General
Real estate	$2,889	$1,894	$3,864	$2,379	$2,867	$2,677
Agricultural	-	722	-	986	126	852
Commercial and Industrial (1)	683	1,850	916	1,028	1,925	1,862
Consumer	343	920	668	1,097	431	686
Unallocated	-	1,122	-	310	-	251
Total loan loss reserves	$3,915	$6,508	$5,448	$5,800	$5,349	$6,328

(1) Includes mortgage warehouse lines

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. LOANS AND LEASES (Continued)

The following tables present the recorded investment in nonaccrual loans and loans past due over 30 days as of December 31, 2015 and December 31, 2014 (dollars in thousands):

December 31, 2015	30-59 Days Past Due	60-89 Days Past Due	90 Days Or More Past Due[2]	Total Past Due	Current	Total Financing Receivables	Non-Accrual Loans[1]
Real Estate:							
1-4 family residential construction	$ 612	$ 545	$ -	$ 1,157	$ 13,784	$ 14,941	$ -
Other Construction/Land	18	129	63	210	37,149	37,359	457
1-4 family - closed-end	1,065	917	566	2,548	134,808	137,356	2,298
Equity Lines	199	247	484	930	43,303	44,233	1,770
Multi-family residential	-	630	-	630	26,592	27,222	630
Commercial real estate owner occupied	232	129	260	621	218,087	218,708	2,325
Commercial real estate Non-owner occupied	-	-	-	-	165,107	165,107	262
Farmland	-	-	-	-	133,182	133,182	610
Total Real Estate Loans	2,126	2,597	1,373	6,096	772,012	778,108	8,352
Agricultural	-	-	-	-	46,237	46,237	-
Commercial and Industrial	127	153	86	366	112,841	113,207	710
Mortage warehouse lines	-	-	-	-	180,355	180,355	-
Consumer loans	98	9	45	152	14,797	14,949	572
Total Gross Loans and Leases	$ 2,351	$ 2,759	$ 1,504	$ 6,614	$ 1,126,242	$ 1,132,856	$ 9,634

[1] Included in Total Financing Receivables

[2] As of December 31, 2015 there were no loans over 90 days past due and still accruing.

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Explanation of Responses:

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. LOANS AND LEASES (Continued)

December 31, 2014	30-59 Days Past Due	60-89 Days Past Due	90 Days Or More Past Due[2]	Total Past Due	Current	Total Financing Receivables	Non-Accrual Loans[1]
Real Estate:							
1-4 family residential construction	$ -	$ 332	$ -	$ 332	$5,526	$ 5,858	$ -
Other Construction/Land	93	59	3,253	3,405	16,503	19,908	3,547
1-4 family - closed-end	1,125	597	2,874	4,596	109,663	114,259	3,042
Equity Lines	98	44	214	356	49,361	49,717	1,049
Multi-family residential	185	-	171	356	18,362	18,718	171
Commercial real estate owner occupied	1,460	26	1,316	2,802	215,852	218,654	3,417
Commercial real estate Non-owner occupied	604	294	6,953	7,851	124,226	132,077	7,754
Farmland	997	-	-	997	144,042	145,039	51
Total Real Estate Loans	4,562	1,352	14,781	20,695	683,535	704,230	19,031
Agricultural	618	-	-	618	27,128	27,746	-
Commercial and Industrial	1,346	153	39	1,538	112,233	113,771	821
Mortgage warehouse lines	-	-	-	-	106,021	106,021	-
Consumer loans	136	17	-	153	18,732	18,885	826
Total Gross Loans and Leases	$ 6,662	$ 1,522	$ 14,820	$ 23,004	$947,649	$ 970,653	$ 20,678

(1) Included in Total Financing Receivables

(2) As of December 31, 2014 there were no loans over 90 days past due and still accruing.

Generally, the Company places a loan or lease on nonaccrual status and ceases recognizing interest income when it has become delinquent more than 90 days and/or when Management determines that the repayment of principal and collection of interest is unlikely. The Company may decide that it is appropriate to continue to accrue interest on certain loans more than 90 days delinquent if they are well-secured by collateral and collection is in process. When a loan is placed on nonaccrual status, any accrued but uncollected interest for the loan is reversed out of interest income in the period in which the loan's status changed. Subsequent payments received from the customer are applied to principal, and no further interest income is recognized until the principal has been paid in full or until circumstances have changed such that payments are again consistently received as contractually required.

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. LOANS AND LEASES (Continued)

Individually impaired loans as of December 31, 2015 and December 31, 2014 were as follows (dollars in thousands):

	December 31, 2015				
	Unpaid Principal Balance(1)	Recorded Investment(2)	Related Allowance	Average Recorded Investment	Interest Income Recognized(3)
With an Allowance Recorded					
Real Estate:					
1-4 family residential construction	$-	$ -	$ -	$ -	$ -
Other Construction/Land	919	769	83	967	42
1-4 Family - closed-end	8,085	6,137	290	6,157	255
Equity Lines	2,339	2,269	214	2,374	17
Multifamily residential	414	414	1	417	5
Commercial real estate- owner occupied	1,272	1,272	589	1,405	139
Commercial real estate- non-owner occupied	3,350	3,350	1,712	3,390	164
Farmland	-	-	-	-	-
Total Real Estate	16,379	14,211	2,889	14,710	622
Agricultural	-	-	-	-	-
Commercial and Industrial	2,572	2,559	683	2,857	97
Consumer loans	2,023	2,022	343	2,298	112
	20,974	18,792	3,915	19,865	831
With no Related Allowance Recorded					
Real Estate:					
1-4 family residential construction	$-	$ -	$ -	$ -	$ -
Other Construction/Land	554	554	-	566	34
1-4 Family - closed-end	585	362	-	602	-
Equity Lines	843	842	-	840	-
Multifamily residential	630	630	-	633	-
Commercial real estate- owner occupied	1,828	1,828	-	2,251	-
Commercial real estate- non-owner occupied	2,006	1,859	-	2,102	118
Farmland	610	610	-	629	-
Total Real Estate	7,056	6,685	-	7,623	152
Agricultural	-	-	-	-	-

Commercial and Industrial	45	29	-	77	-
Consumer loans	160	15	-	256	-
	7,261	6,729	-	7,956	152
Total	$28,235	$ 25,521	$ 3,915	$ 27,821	$ 983

(1)Contractual principal balance due from customer.

(2)Principal balance on Company's books, less any direct charge offs.

(3)Interest income is recognized on performing balances on a regular accrual basis.

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. LOANS AND LEASES (Continued)

	December 31, 2014				
	Unpaid Principal Balance(1)	Recorded Investment(2)	Related Allowance	Average Recorded Investment	Interest Income Recognized(3)
With an Allowance Recorded					
Real Estate:					
1-4 family residential construction	$-	$ -	$ -	$ -	$ -
Other Construction/Land	1,155	1,078	179	1,193	70
1-4 Family - closed-end	4,167	4,167	288	4,276	258
Equity Lines	797	797	230	878	14
Multifamily residential	171	171	51	173	-
Commercial real estate- owner occupied	2,791	2,681	1,385	3,069	60
Commercial real estate- non-owner occupied	3,463	3,463	1,731	3,545	263
Farmland	-	-	-	-	-
Total Real Estate	12,544	12,357	3,864	13,134	665
Agricultural	-	-	-	-	-
Commercial and Industrial	2,910	2,898	916	3,046	123
Consumer loans	2,790	2,788	668	3,115	150
	18,244	18,043	5,448	19,295	938
With no Related Allowance Recorded					
Real Estate:					
1-4 family residential construction	$-	$ -	$ -	$ -	$ -
Other Construction/Land	3,345	3,345	-	4,143	-
1-4 Family - closed-end	2,943	2,943	-	9,186	-
Equity Lines	609	570	-	611	-
Multifamily residential	-	-	-	-	-
Commercial real estate- owner occupied	2,915	1,939	-	3,046	-
Commercial real estate- non-owner occupied	9,563	9,416	-	10,306	118
Farmland	51	50	-	52	-
Total Real Estate	19,426	18,263	-	27,344	118
Agricultural	-	-	-	-	-
Commercial and Industrial	35	18	-	81	-
Consumer loans	275	100	-	347	-

	19,736	18,381	-	27,772	118
Total	$37,980	$ 36,424	$ 5,448	$ 47,067	$ 1,056

(1)Contractual principal balance due from customer.

(2)Principal balance on Company's books, less any direct charge offs.

(3)Interest income is recognized on performing balances on a regular accrual basis.

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. LOANS AND LEASES (Continued)

Included in loans above are troubled debt restructurings that were classified as impaired. The Company had $2,231,000 and $2,592,000 in commercial loans, $12,173,000 and $21,302,000 in real estate secured loans and $1,866,000 and $2,640,000 in consumer loans, which were modified as troubled debt restructurings and consequently classified as impaired at December 31, 2015 and 2014, respectively.

Additional commitments to existing customers with restructured loans totaled $1,515,000 and $3,584,000 at December 31, 2015 and 2014, respectively.

Interest income recognized on impaired loans was $983,000, $1,056,000, and $1,220,000, for the years ended December 31, 2015, 2014, and 2013, respectively. There was no interest income recognized on a cash basis on impaired loans for the years ended December 31, 2015, 2014, and 2013, respectively.

The following is a summary of interest income from non-accrual loans in the portfolio at year-end that was not recognized (dollars in thousands):

	Years Ended December 31,		
	2015	2014	2013
Interest that would have been recorded under the loans' original terms	$643	$1,666	$3,209
Less gross interest recorded	188	389	304
Foregone interest	$455	$1,277	$2,905

Certain loans have been pledged to secure short-term borrowing arrangements (see Note 9). These loans totaled $555,874,000 and $475,979,000 at December 31, 2015 and 2014, respectively.

Salaries and employee benefits totaling $3,058,000, $2,673,000, and $2,804,000, have been deferred as loan and lease origination costs to be amortized over the estimated lives of the related loans and leases for the years ended December

31, 2015, 2014, and 2013, respectively.

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. LOANS AND LEASES (Continued)

During the periods ended December 31, 2015 and 2014, the terms of certain loans were modified as troubled debt restructurings. Types of modifications applied to these loans include a reduction of the stated interest rate, a modification of term, an agreement to collect only interest rather than principal and interest for a specified period, or any combination thereof.

The following tables present troubled debt restructurings by type of modification during the period ending December 31, 2015 and December 31, 2014 (dollars in thousands):

December 31, 2015	Rate Modification	Term Modification	Rate & Term Modification	Term & Interest Only Modification	Total
Troubled Debt Restructurings					
Real Estate:					
Other Construction/Land	$ -	$ 111	$ -	$ -	$111
1-4 family - closed-end	-	-	4,882	-	4,882
Equity Lines	-	1,164	290	-	1,454
Multi-family Residential	-	418			418
Commercial real estate owner occupied	-	-	-	-	-
Commercial real estate					
Non-owner occupied	-	-	-	-	-
Total Real Estate Loans	-	1,693	5,172	-	6,865
Agricultural	-	-	-	-	-
Commercial and Industrial	-	140	-	-	140
Consumer Loans	-	23	-	-	23
	$ -	$ 1,856	$ 5,172	$ -	$7,028

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. LOANS AND LEASES (Continued)

December 31, 2014	Rate Modification	Term Modification	Rate & Term Modification	Term & Interest Only Modification	Total
Troubled Debt Restructurings					
Real Estate:					
Other Construction/Land	$ -	$ -	$ 40	$ -	$40
1-4 family - closed-end	41	13	-	-	54
Equity Lines	-	945	29	-	974
Commercial real estate owner occupied	279	123	-	-	402
Commercial real estate					
Non-owner occupied	-	-	-	-	-
Total Real Estate Loans	320	1,081	69	-	1,470
Agricultural	-	-	-	-	-
Commercial and Industrial	-	153	28	30	211
Consumer Loans	-	9	103	-	112
	$ 320	$ 1,243	$ 200	$ 30	$1,793

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. LOANS AND LEASES (Continued)

The following tables present loans by class modified as troubled debt restructurings including any subsequent defaults during the period ending December 31, 2015 and December 31, 2014 (dollars in thousands):

December 31, 2015	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Reserve Difference[1]
Real Estate:				
Other Construction/Land	2	$ 111	$ 111	$ 4
1-4 family - closed-end	15	4,883	4,882	154
Equity Lines	12	1,454	1,454	176
Multi-family Residential	1	418	418	-
Commercial real estate owner occupied	0	-	-	-
Commercial real estate non-owner occupied	0	-	-	-
Total Real Estate Loans		6,866	6,865	334
Agricultural	0	-	-	-
Commercial and Industrial	5	140	140	(16)
Consumer Loans	2	23	23	7
		$ 7,029	$ 7,028	$ 325

[1] This represents the increase or (decrease) in the allowance for loans and lease losses reserve for these credits measured as the difference between the specific post-modification impairment reserve and the pre-modification reserve calculated under our general allowance for loan loss methodology.

	Subsequent Defaults		
December 31, 2015	Number of Loans	Recorded Investment	Charge-Offs
Real Estate:			
Other Construction/Land	0	$ -	$ -
1-4 family - closed-end	0	-	-
Equity Lines	0	-	-

Commercial real estate- owner occupied	0	-	-
Commercial real estate- non owner occupied	0	-	-
Total Real Estate Loans		-	-
Agricultural	0	-	-
Commercial and Industrial	0	-	-
Consumer Loans	0	-	-
		$ -	$ -

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. LOANS AND LEASES (Continued)

December 31, 2014	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Reserve Difference[1]
Real Estate:				
Other Construction/Land	1	$ 40	$ 40	$ -
1-4 family - closed-end	2	54	54	-
Equity Lines	11	974	974	364
Commercial real estate owner occupied	2	402	402	-
Commercial real estate non-owner occupied	0	-	-	-
Total Real Estate Loans		1,470	1,470	364
Agricultural	0	-	-	-
Commercial and Industrial	9	211	211	75
Consumer Loans	4	112	112	15
		$ 1,793	$ 1,793	$ 454

[1] This represents the increase or (decrease) in the allowance for loans and lease losses reserve for these credits measured as the difference between the specific post-modification impairment reserve and the pre-modification reserve calculated under our general allowance for loan loss methodology.

December 31, 2014	Subsequent Defaults		
	Number of Loans	Recorded Investment	Charge-Offs
Real Estate:			
Other Construction/Land	4	$ 1,768	$ 77
1-4 family - closed-end	2	8,305	-
Equity Lines	0	-	-
Commercial real estate- owner occupied	2	937	31
Commercial real estate- non owner occupied	0	-	-
Total Real Estate Loans		11,010	108
Agricultural	0	-	-
Commercial and Industrial	2	129	2
Consumer Loans	2	133	58

$ 11,272	$ 168

In the tables above, the TDRs that subsequently defaulted increased the allowance for loan and lease losses by $0 and $51,000 for the years ended December 31, 2015 and 2014. The total allowance for loan and lease losses specifically allocated to the balances that were classified as TDRs during the year ended December 31, 2015 and 2014 is $1,486,000 and $2,714,000, respectively.

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. LOANS AND LEASES (Continued)

Interest income for all performing loans, regardless of class (Pass, Special Mention, Substandard and Impaired), is recognized on an accrual basis, with interest accrued daily. Costs associated with successful loan originations are netted from loan origination fees, with the net amount (net deferred loan fees) amortized over the contractual life of the loan in interest income. If a loan has scheduled periodic payments, the amortization of the net deferred loan fee is calculated using the effective interest method over the contractual life of the loan. If the loan does not have scheduled payments, such as a line of credit, the net deferred loan fee is recognized as interest income on a straight line basis over the contractual life of the loan. Fees received for loan commitments are recognized as interest income over the term of the commitment. When loans are repaid, any remaining unamortized balances of deferred fees and costs are accounted for through interest income.

Loan Servicing

The Company originates mortgage loans for sale to investors. During the years ended December 31, 2015, 2014, and 2013, all mortgage loans that were sold by the Company were sold without retention of related servicing. The Company’s servicing portfolio at December 31, 2015, 2014, and 2013 totaled $425,000, $770,000, and $1,585,000, respectively. At December 31, 2015, loans were principally serviced for one investor.

Purchased Credit Impaired Loans

As part of the acquisition described in Note 21 *Business Combination*, the Company acquired on November 14, 2014, a portfolio of loans, some of which have shown evidence of credit deterioration since origination and it was probable at acquisition that all contractually required payments would not be collected. The carrying amount and unpaid principal balance of those loans are as follows (dollars in thousands):

	December 31, 2015	
	Unpaid Principal Balance	Carrying Value

Real estate secured	$ 1,158	$ 188
Commercial and industrial	38	-
Consumer	1	-
Total purchased credit impaired loans	$ 1,197	$ 188

	December 31, 2014	
	Unpaid Principal Balance	Carrying Value
Real estate secured	$ 1,222	$ 228
Commercial and industrial	92	-
Consumer	1	-
Total purchased credit impaired loans	$ 1,315	$ 228

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. LOANS AND LEASES (Continued)

No ALLL was recorded on purchased credit impaired loans as of December 31, 2015 and 2014. Purchased credit impaired loans acquired during the years ended December 31, 2015 and 2014 for which it was probable at acquisition that not all contractually required payments would be collected are as follows (dollars in thousands):

	2015	2014
Contractually required payments receivable of loans pursHased during the year:		
Consumer	$ -	$ 572
Sierra Reserve	-	875
Non-accretable difference	-	(1,221)
Cash flows expected to be collected at acquisition	-	226
Fair value of acquired loans at acquisition	$ -	$ 226

Accretable yield, or income expected to be collected is as follows:

	Years Ended December 31,		
	2015	2014	2013
Balance at January 1	$ 1,106	$ -	$ -
New loans purchased	-	1,106	-
Accretion of income	(218)	-	-
Reclassifications from non-accretable difference	-	-	-
Disposals		-	-
Balance at December 31	$ 888	$ 1,106	$ -

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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5. PREMISES AND EQUIPMENT

Premises and equipment at cost consisted of the following (dollars in thousands):

	December 31,	
	2015	2014
Land	$3,019	$3,019
Buildings and improvements	16,398	16,348
Furniture, fixtures and equipment	18,166	18,397
Leasehold improvements	11,049	10,850
	48,632	48,614
Less accumulated depreciation and amortization	26,826	26,808
Construction in progress	184	47
	$21,990	$21,853

Depreciation and amortization included in occupancy and equipment expense totaled $2,272,000, $2,107,000, and $2,119,000, for the years ended December 31, 2015, 2014, and 2013, respectively.

Operating Leases

The Company leases certain of its branch properties under non-cancelable operating leases. Rental expense included in occupancy and equipment expense totaled $1,256,000, $1,017,000, and $1,001,000 and for the years ended December 31, 2015, 2014, and 2013, respectively.

Rent commitments, before considering renewal options that generally are present, were as follows:

Year Ending December 31,	
2016	$1,190,000
2017	1,141,000
2018	1,044,000
2019	790,000
2020	787,000
Thereafter	3,207,000
	$8,159,000

The Company has options to renew its branch facilities after the initial leases expire. The renewal options range from one to ten years and are not included in the payments reflected above.

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

6. GOODWILL AND INTANGIBLE ASSETS

Goodwill

The change in goodwill during the year is as follows (dollars in thousands):

	Years Ended December 31,		
	2015	2014	2013
Balance at January 1	$ 6,908	$ 5,544	$ 5,544
Acquired goodwill	-	1,364	-
Impairment	-	-	-
Balance at December 31	$ 6,908	$ 6,908	$ 5,544

Impairment exists when a reporting unit’s carrying value of goodwill exceeds its fair value. Bank of the Sierra (the “Bank”) is the only subsidiary of the Company that meets the materiality criteria necessary to be deemed an operating segment, and because the Company exists primarily for the purpose of holding the stock of the Bank we have determined that only one unified operating segment (the consolidated Company) exists. At December 31, 2015, the Company had positive equity and the Company elected to perform a qualitative assessment to determine if it was more likely than not that the fair value of the Company exceeded its carrying value, including goodwill. The qualitative assessment indicated that it was more likely than not that the fair value of the reporting unit exceeded its carrying value, resulting in no impairment.

Acquired Intangible Assets

Acquired intangible assets were as follows at year-end (dollars in thousands):

	Years Ended December 31,			
	2015		2014	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Core deposit intangibles	$1,075	$ 145	$1,075	$ 11

Aggregate amortization expense was $134,000, $11,000, and $0 for 2015, 2014, and 2013.

Estimated amortization expense for each of the next five years and thereafter (dollars in thousands):

2016	$134
2017	$134
2018	$134
2019	$134
2020	$134
Thereafter	$260
	$930

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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7. OTHER ASSETS

Other assets consisted of the following (dollars in thousands):

	December 31,	
	2015	2014
Accrued interest receivable	$5,808	$5,852
Deferred tax assets	12,283	12,810
Investment in limited partnerships	6,217	7,276
Federal Home Loan Bank stock, at cost	7,135	6,631
Other	7,126	4,912
	$38,569	$37,481

The Company has invested in limited partnerships that operate qualified affordable housing projects to receive tax benefits in the form of tax deductions from operating losses and tax credits. The Company accounts for these investments under the cost method and management analyzes these investments annually for potential impairment. The Company had no remaining capital commitments to these partnerships at December 31, 2015.

The Company holds certain equity investments that are not readily marketable securities and thus are classified as "other assets" on the Company's balance sheet. These include investments in Pacific Coast Bankers Bancshares, California Economic Development Lending Initiative, and the Federal Home Loan Bank ("FHLB"). The largest of these is the Company's $7,135,000 investment in FHLB stock, carried at cost. Quarterly, the FHLB evaluates and adjusts the Company's minimum stock requirement based on the Company's borrowing activity and membership requirements. Any stock deemed in excess is automatically repurchased by the FHLB at cost.

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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8. DEPOSITS

Interest-bearing deposits consisted of the following (dollars in thousands):

	December 31,	
	2015	2014
Interest Bearing Demand Deposits	$125,210	$110,840
NOW	306,630	275,494
Savings	193,052	167,655
Money Market	101,562	117,907
CDAR's, under $250,000	14,109	11,299
Time, under $250,000	141,773	151,719
Time, $250,000 or more	150,041	135,884
Brokered Deposits	-	5,000
	$1,032,377	$975,798

Aggregate annual maturities of time deposits were as follows (dollars in thousands):

Year Ending December 31,	
2016	$296,521
2017	$4,328
2018	$1,655
2019	$1,981
2020	$735
Thereafter	$702
	$305,922

Interest expense recognized on interest-bearing deposits consisted of the following (dollars in thousands):

	Year Ended December 31,		
	2015	2014	2013
Interest bearing demand deposits	$355	$283	$281
NOW	344	338	359
Savings	207	241	285
Money market	78	80	94
CDAR's	8	11	36
Time deposits	782	1,017	1,243
Brokered Deposits	11	94	157
	$1,785	$2,064	$2,455

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

9. OTHER BORROWING ARRANGEMENTS

At year end, short-term borrowings consisted of the following (dollars in thousands):

	2015					2014				
	Average balance outstanding	Amount	Average interest rate during the year	Maximum month-end balance during the year	Weighted average interest rate	Average balance outstanding	Amount	Average interest rate during the year	Maximum month-end balance during the year	Weighted average interest rate
As of December 31:										
Repurchase agreements	$8,601	$9,405	.41 %	$11,272	.40 %	$5,936	$7,251	.35 %	$7,739	.40 %
Overnight Federal Home Loan Bank advances	14,697	75,300	.21 %	98,800	.27 %	3,502	18,200	.11 %	25,180	.25 %
	$23,298	$84,705		$110,072		$9,438	$25,451		$32,919	

At year end, long-term borrowings consisted of the following (dollars in thousands):

	2015			2014		
	Amount	Fixed rate	Weighted average interest rate	Amount	Fixed rate	Weighted average interest rate
As of December 31:						
Federal Home Loan Bank advances, maturing 2015	$-	-		$4,000	0.29 %	
Federal Home Loan Bank advances, maturing 2016	2,000	0.54 %		2,000	0.54 %	
	$2,000		0.54 %	$6,000		0.37 %

Each advance is payable at its maturity date, with a prepayment penalty for fixed rate advances. The advances were collateralized by $431,050,000 of first mortgage loans under a blanket lien arrangement at year end 2015. Based on this collateral and the Company's holdings of FHLB stock, the Company was eligible to borrow up to the total of $289,369,000 at year-end 2015, with a remaining borrowing capacity of $160,739,000 if sufficient additional collateral was pledged.

The Company had unsecured lines of credit with its correspondent banks which, in the aggregate, amounted to $70,000,000 at December 31, 2015 and 2014, respectively, at interest rates which vary with market conditions. There was $0 outstanding under these lines of credit at December 31, 2015 and December 31, 2014, respectively.

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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10. INCOME TAXES

The provision for income taxes follows (dollars in thousands):

	Year Ended December 31,		
	2015	2014	2013
Federal:			
Current	$5,451	$5,738	$563
Deferred	1,028	(1,281)	1,842
	6,479	4,457	2,405
State:			
Current	1,928	1,604	170
Deferred	664	130	518
	2,592	1,734	688
	$9,071	$6,191	$3,093

The components of the net deferred tax asset, included in other assets, are as follows (dollars in thousands):

	December 31,	
	2015	2014
Deferred tax assets:		
Allowance for loan losses	$4,496	$4,877
Foreclosed assets	1,204	1,208
Deferred compensation	4,386	4,227
Accrued reserves	500	613
Non accrual loans	378	245
Other than temporary impairment charge	450	565
Credit carryforward	3,100	5,676
Net operating loss carryforward	1,664	1,709
Other	3,144	1,207
Total deferred tax assets	19,322	20,327

Deferred tax liabilities:		
Premises and equipment	(815)	(726)
Deferred loan costs	(2,640)	(2,442)
Unrealized gain on securities available-for-sale	(1,846)	(3,011)
Other	(1,738)	(1,338)
Total deferred tax liabilities	(7,039)	(7,517)
Net deferred tax assets	$12,283	$12,810

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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10. INCOME TAXES (Continued)

The expense for income taxes differs from amounts computed by applying the statutory Federal income tax rates to income before income taxes. The significant items comprising these differences consisted of the following (dollars in thousands):

	Year Ended December 31,		
	2015	2014	2013
Income tax expense at Federal statutory rate	$9,498	$7,501	$5,597
Increase (decrease) resulting from:			
State franchise tax expense, net of Federal tax effect	1,671	1,116	414
Tax exempt income	(1,034)	(1,018)	(920)
Affordable housing tax credits	(770)	(1,006)	(1,257)
Other	(294)	(402)	(741)
	$9,071	$6,191	$3,093
Effective tax rate	33.4 %	28.9 %	18.8 %

The Company is subject to federal income tax and income tax of the state of California. Our federal income tax returns for the years ended December 31, 2012, 2013 and 2014 are open to audit by the federal authorities and our California state tax returns for the years ended December 31, 2011, 2012, 2013 and 2014 are open to audit by the state authorities.

The Company has net operating loss carry forwards of approximately $3,800,000 for federal income and approximately $4,400,000 for California franchise tax purposes. Net operating loss carry forwards, to the extent not used will begin to expire in 2029. Net operating loss carry forwards available from acquisitions are substantially limited by Section 382 of the Internal Revenue Code and benefits not expected to be realized due to the limitation have been excluded from the deferred tax asset and net operating loss carry forward amounts noted above.

There were no recorded interest or penalties related to uncertain tax positions as part of income tax for the years ended December 31, 2015, 2014, and 2013, respectively. We do not expect the total amount of unrecognized tax benefits to significantly increase or decrease within the next twelve months.

11. SUBORDINATED DEBENTURES

Sierra Statutory Trust II ("Trust II") and Sierra Capital Trust III ("Trust III"), (collectively, the "Trusts") were formed by the Company for the sole purpose of issuing trust preferred securities fully and unconditionally guaranteed by the Company. For financial reporting purposes, the Trusts are not consolidated and the Floating Rate Junior Subordinated Deferrable Interest Debentures (the "Subordinated Debentures") held by the Trusts and issued and guaranteed by the Company are reflected in the Company's consolidated balance sheet in accordance with provisions of ASC Topic 810. Under applicable regulatory guidance, the amount of trust preferred securities that is eligible as Tier 1 capital is limited to twenty-five percent of the Company's Tier 1 capital on a pro forma basis. At December 31, 2015, all $30,000,000 of the Company's trust preferred securities qualified as Tier 1 capital.

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

11. SUBORDINATED DEBENTURES (Continued)

During the first quarter of 2004, Sierra Statutory Trust II issued 15,000 Floating Rate Capital Trust Pass-Through Securities (TRUPS II), with a liquidation value of $1,000 per security, for gross proceeds of $15,000,000. The entire proceeds of the issuance were invested by Trust II in $15,464,000 of Subordinated Debentures issued by the Company, with identical maturity, re-pricing and payment terms as the TRUPS II. The Subordinated Debentures, purchased by Trust II, represent the sole assets of the Trust II. Those Subordinated Debentures mature on March 17, 2034, bear a current interest rate of 3.28% (based on 3-month LIBOR plus 2.75%), with re-pricing and payments due quarterly.

Those Subordinated Debentures are currently redeemable by the Company, subject to receipt by the Company of prior approval from the Federal Reserve Bank, on any March 17th, June 17th, September 17th, or December 17th. The redemption price is par plus accrued and unpaid interest, except in the case of redemption under a special event which is defined in the debenture.

The TRUPS II are subject to mandatory redemption to the extent of any early redemption of the related Subordinated Debentures and upon maturity of the Subordinated Debentures on March 17, 2034.

Trust II has the option to defer payment of the distributions for a period of up to five years, as long as the Company is not in default on the payment of interest on the Subordinated Debentures. The TRUPS II issued in the offering were sold in private transactions pursuant to an exemption from registration under the Securities Act of 1933, as amended. The Company has guaranteed, on a subordinated basis, distributions and other payments due on the TRUPS II.

During the second quarter of 2006, Sierra Capital Trust III issued 15,000 Floating Rate Capital Trust Pass-Through Securities (TRUPS III), with a liquidation value of $1,000 per security, for gross proceeds of $15,000,000. The entire proceeds of the issuance were invested by Trust III in $15,464,000 of Subordinated Debentures issued by the Company, with identical maturity, repricing and payment terms as the TRUPS III. The Subordinated Debentures, purchased by Trust III, represent the sole assets of the Trust III. Those Subordinated Debentures mature on September 23, 2036, bear a current interest rate of 1.99% (based on 3-month LIBOR plus 1.40%), with repricing and payments due quarterly.

Those Subordinated Debentures are redeemable by the Company, subject to receipt by the Company of prior approval from the Federal Reserve Bank, on any March 23rd, June 23rd, September 23rd, or December 23rd. The redemption price is par plus accrued and unpaid interest, except in the case of redemption under a special event which is defined in the debenture. The TRUPS III are subject to mandatory redemption to the extent of any early redemption of the related Subordinated Debentures and upon maturity of the Subordinated Debentures on September 23, 2036.

Trust III has the option to defer payment of the distributions for a period of up to five years, as long as the Company is not in default on the payment of interest on the Subordinated Debentures. The TRUPS III issued in the offering were sold in private transactions pursuant to an exemption from registration under the Securities Act of 1933, as amended. The Company has guaranteed, on a subordinated basis, distributions and other payments due on the TRUPS III.

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

12. COMMITMENTS AND CONTINGENCIES

Letter of Credit

The Company holds two letters of credit with the Federal Home Loan Bank of San Francisco totaling $97,086,000. A $90,000,000 letter of credit is pledged to secure public deposits at December 31, 2015 and a $7,086,000 standby letter of credit was obtained on behalf of one of our customers to guarantee financial performance. Should the standby letter of credit be drawn upon, the customer would reimburse the Company from an existing line of credit.

Federal Reserve Requirements

Banks are required to maintain reserves with the Federal Reserve Bank equal to a specified percentage of their reservable deposits less vault cash. There were no reserve balances maintained at the Federal Reserve Bank at December 31, 2015 and 2014, respectively.

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. These financial instruments consist of commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet.

The Company’s exposure to credit loss in the event of nonperformance by the other party 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 letters of credit as it does for loans included on the balance sheet.

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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12. COMMITMENTS AND CONTINGENCIES (Continued)

The following financial instruments represent off-balance-sheet credit risk (dollars in thousands):

	December 31,	
	2015	2014
Fixed-rate commitments to extend credit	$82,668	$83,416
Variable-rate commitments to extend credit	$272,222	$283,493
Standby letters of credit	$16,654	$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 of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments to extend credit are made at both fixed and variable rates of interest as stated in the table above. Standby letters of credit are generally unsecured and are issued by the Company to guarantee the performance of a customer to a third party, while commercial letters of credit represent the Company’s commitment to pay a third party on behalf of a customer upon fulfillment of contractual requirements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

Concentration in Real Estate Lending

At December 31, 2015, in management’s judgment, a concentration of loans existed in real estate related loans. At that date, approximately 69% of the Company’s loans were real estate related. Balances secured by commercial buildings and construction and development loans represented 56% of all real estate loans, while loans secured by non-construction residential properties accounted for 27%, and loans secured by farmland were 17% of real estate loans. Although management believes the loans within these concentrations have no more than the normal risk of collectability, a further decline in the performance of the economy in general or a further decline in real estate values in the Company’s primary market areas, in particular, could have an adverse impact on collectability.

Concentration by Geographic Location

The Company grants commercial, real estate mortgage, real estate construction and consumer loans to customers primarily in the South Central San Joaquin Valley of California, specifically Tulare, Fresno, Kern, Kings and Madera counties and the Southern California corridor between Santa Paula and Santa Clarita in the counties of Ventura and Los Angeles. The ability of a substantial portion of the Company’s customers to honor their contracts is dependent on the economy in these areas. Although the Company’s loan portfolio is diversified, there is a relationship in those regions between the local agricultural economy and the economic performance of loans made to non-agricultural customers.

Contingencies

The Company is subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the consolidated financial position or results of operations of the Company.

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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13. SHAREHOLDERS' EQUITY

Share Repurchase Plan

At December 31, 2015, the Company had a stock repurchase plan which has no expiration date. During the year ended December 31, 2015, the Company repurchased 472,333 shares. The total number of shares available for repurchase at December 31, 2015 was 104,319. Repurchases are generally made in the open market at market prices.

Earnings Per Share

A reconciliation of the numerators and denominators of the basic and diluted earnings per share computations is as follows:

	For the Years Ended December 31,		
	2015	2014	2013
Basic Earnings Per Share			
Net income (dollars in thousands)	$18,067	$15,240	$13,369
Weighted average shares outstanding	13,460,605	14,001,958	14,155,927
Basic earnings per share	$1.34	$1.09	$0.94
Diluted Earnings Per Share			
Net income (dollars in thousands)	$18,067	$15,240	$13,369
Weighted average shares outstanding	13,460,605	14,001,958	14,155,927
Effect of dilutive stock options	124,505	134,528	134,223

Weighted average shares outstanding	13,585,110	14,136,486	14,290,150
Diluted earnings per share	$1.33	$1.08	$0.94

Stock Options

In June 1998, Bank of the Sierra adopted the 1998 Stock Option Plan (the “1998 Plan”) for which shares were reserved for issuance to employees and directors under incentive and non-statutory agreements. The 1998 Plan was assumed by the Company effective August 10, 2001. Effective May 23, 2007, the 1998 Plan was terminated and no further options may be granted thereunder, but options granted under the 1998 Plan which were outstanding as of the termination date were not affected by this termination. As of December 31, 2015, options granted under the 1998 Plan covering 44,300 shares were still outstanding.

On March 15, 2007 the Board of Directors approved and adopted the Company’s 2007 Stock Incentive Plan (the “2007 Plan”), which was approved by the Company’s shareholders on May 23, 2007. 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 and its subsidiaries. The 2007 Plan also provides for the issuance of restricted stock awards to these same classes of eligible participants, which awards may be granted on such terms and conditions as are established by the Board of Directors or the Compensation Committee in its discretion. We have not issued, nor do we currently have plans to issue, restricted stock awards.

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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13. SHAREHOLDERS' EQUITY (Continued)

The maximum number of shares subject to issuance under the 2007 Plan was originally 1,500,000 shares of the Company's authorized but unissued common stock, covering both restricted stock awards and stock options. The number subject to issuance under the 2007 Plan had declined to 808,980 at December 31, 2015, due to stock options already granted under the plan net of any canceled options that were returned to the pool available for issuance.

All options granted under the 2007 Plan have been or will be granted at an exercise price of not less than 100% of the fair market value of the stock on the date of grant, exercisable in installments as provided in individual stock option agreements. In the event of a "Change in Control" as defined in the 2007 Plan, all outstanding options shall become exercisable in full (subject to certain notification requirements), and shall terminate if not exercised within a specified period of time unless such options are assumed by the successor corporation or substitute options are granted. Options also terminate in the event an optionee ceases to be employed by or to serve as a director of the Company or its subsidiaries, and the vested portion thereof must be exercised within 30 days after such cessation of employment or service.

A summary of the Company's stock option activity, including options from the 1998 Plan, follows (shares in thousands, except exercise price):

	2015			2014		2013	
	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value[1]	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of year	629	$ 15.30		743	$ 14.61	927	$ 14.16
Exercised	(37)	$ 10.19		(95)	$ 11.28	(111)	$ 9.87
Granted	25	$ 16.55		50	$ 16.35	-	$ -
Canceled	(117)	$ 19.21		(69)	$ 14.20	(73)	$ 16.06
Outstanding, end of year	500	$ 14.83	$ 2,850	629	$ 15.30	743	$ 14.61
	430	$ 15.20	$ 2,122	527	$ 16.25	539	$ 16.26

Exercisable,
end of year[2]

[1]The aggregate intrinsic value of stock option in the table above represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on December 31, 2015. This amount changes based on changes in the market value of the Company's stock.

[2]The weighted average remaining contractual life of stock options outstanding and exercisable on December 31, 2015 was 5.20 years and 4.84 years, respectively.

Information related to stock options during each year follows:

	2015	2014	2013
Weighted-average grant-date fair value per share	$2.89	$2.67	$-
Total intrinsic value of stock options exercised	$244,000	$468,000	$605,000
Total fair value of stock options vested	$176,000	$367,000	$583,000

Cash received from the exercise of 37,240 shares was $379,440 for the period ended December 31, 2015 with a related tax benefit of $72,000.

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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13. SHAREHOLDERS' EQUITY (Continued)

The Company is using the Black-Scholes model to value stock options. In accordance with U.S. GAAP, charges of $35,000, $181,000, and $268,000 are reflected in the Company's income statements for the years ended December 31, 2015, 2014, and 2013, respectively, as pre-tax compensation and directors' expense related to stock options. The related tax benefit of these options is $0, $33,000, and $2,000 for the years ended December 31, 2015, 2014, and 2013, respectively.

Unamortized compensation expense associated with unvested stock options outstanding at December 31, 2015 was $77,000, which will be recognized over the next 4.3 years.

14. REGULATORY MATTERS

The Company and the Bank are subject to certain regulatory capital requirements administered by the Board of Governors of the Federal Reserve System and the FDIC. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgements by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The net unrealized gain on available for sale securities is not included in computing regulatory capital. Capital amounts and ratios for December 31. 2014 are calculated using Basel I rules. Management believes as of December 31, 2015, the Company and the Bank meet all capital adequacy requirements to which they are subject. Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end December 31, 2015 and 2014, notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category.

Actual and required capital amounts (in thousands) and ratios are presented below at year end.

	2015 Capital Amount	Ratio	2014 Capital Amount	Ratio
Leverage Ratio				
Sierra Bancorp and subsidiary	$207,576	12.14%	$199,853	12.99%
Minimum requirement for "Well-Capitalized" institutions	85,526	5.0 %	76,926	5.0 %
Minimum regulatory requirement	68,421	4.0 %	61,541	4.0 %
Bank of the Sierra	$205,055	12.00%	$195,174	12.72%
Minimum requirement for "Well-Capitalized" institutions	85,276	5.0 %	76,706	5.0 %
Minimum regulatory requirement	68,221	4.0 %	61,365	4.0 %

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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14. REGULATORY MATTERS (Continued)

	2015 Capital Amount	2015 Ratio	2014 Capital Amount	2014 Ratio
Common Equity Tier 1 Capital Ratio				
Sierra Bancorp and subsidiary	$207,576	13.98%	N/A	N/A
Minimum requirements for "Well-Capitalized" institutions	83,428	6.5 %	N/A	N/A
Minimum regulatory requirement	57,758	4.5 %	N/A	N/A
Bank of the Sierra	$205,055	16.01%	N/A	N/A
Minimum requirements for "Well-Capitalized" institutions	83,276	6.5 %	N/A	N/A
Minimum regulatory requirement	57,653	4.5 %	N/A	N/A

	Capital Amount	Ratio	Capital Amount	Ratio
Tier 1 Risk-Based Capital Ratio				
Sierra Bancorp and subsidiary	$207,576	16.17%	$199,903	17.39%
Minimum requirement for "Well-Capitalized" institutions	102,680	8.0 %	68,972	6.0 %
Minimum regulatory requirement	77,010	6.0 %	45,981	4.0 %
Bank of the Sierra	$205,055	16.01%	$195,174	17.01%
Minimum requirement for "Well-Capitalized" institutions	102,494	8.0 %	68,843	6.0 %
Minimum regulatory requirement	76,870	6.0 %	45,895	4.0 %
Total Risk-Based Capital Ratio				
Sierra Bancorp and subsidiary	$218,315	17.01%	$211,973	18.44%
Minimum requirement for "Well-Capitalized" institutions	128,350	10.0 %	114,953	10.0 %
Minimum regulatory requirement	102,680	8.0 %	91,962	8.0 %
Bank of the Sierra	$215,794	16.84%	$206,736	18.02%
Minimum requirement for "Well-Capitalized" institutions	128,117	10.0 %	114,739	10.0 %
Minimum regulatory requirement	102,494	8.0 %	91,791	8.0 %

Under current rules of the Federal Reserve Board, qualified trust preferred securities are one of several “restricted” core capital elements which may be included in Tier 1 capital in an aggregate amount limited to 25% of all core capital elements, net of goodwill less any associated deferred tax liability. Amounts of restricted core capital elements in excess of these limits generally may be included in Tier 2 capital. Since the Company had less than $15 billion in assets at December 31, 2015, under the Dodd-Frank Act the Company will be able to continue to include its existing trust preferred securities in Tier 1 Capital to the extent permitted by FRB guidelines.

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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14. REGULATORY MATTERS (Continued)

Dividend Restrictions

The Company's ability to pay cash dividends is dependent on dividends paid to it by the Bank, and is also limited by state corporation law. The California General Corporation Law allows a California corporation to pay dividends if the Company's retained earnings equal at least the amount of the proposed dividend. If the Company does not have sufficient retained earnings available for the proposed dividend, it may still pay a dividend to its shareholders if immediately after giving effect to the dividend the sum of the company's assets (exclusive of goodwill and deferred charges) would be at least equal to 125% of its liabilities (not including deferred taxes, deferred income and other deferred liabilities) and the current assets of the company would be at least equal to its current liabilities, or, if the average of its earnings before taxes on income and before interest expense for the two preceding fiscal years was less than the average of its interest expense for the two preceding fiscal years, at least equal to 125% of its current liabilities.

Dividends from the Bank to the Company are restricted under California law to the lesser of the Bank's retained earnings or the Bank's net income for the latest three fiscal years, less dividends previously declared during that period, or, with the approval of the Department of Business Oversight, to the greater of the retained earnings of the Bank, the net income of the Bank for its last fiscal year, or the net income of the Bank for its current fiscal year. As of December 31, 2015, the maximum amount available for dividend distribution under this restriction was approximately $17,735,000.

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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15. BENEFIT PLANS

Salary Continuation Agreements, Directors' Retirement and Officer Supplemental Life Insurance Plans

The Company has entered into salary continuation agreements with its executive officers, and has established retirement plans for qualifying members of the Board of Directors. The plans provide for annual benefits for up to fifteen years after retirement or death. The benefit obligation under these plans totaled $5,213,000 and $5,159,000 and was fully accrued for the years ended December 31, 2015 and 2014, respectively. The expense recognized under these arrangements totaled $345,000, $320,000 and $288,000 for the years ended December 31, 2015, 2014 and 2013, respectively. Salary continuation benefits paid to former directors or executives of the Company or their beneficiaries totaled $291,000, $112,000 and $83,000 for the years ended December 31, 2015, 2014 and 2013. The Company also provided benefits to former executives of Sierra National Bank under salary continuation plans that were in effect at the time Sierra National Bank was merged into Bank of the Sierra. The benefit obligation under these plans was fully accrued and was zero for each the years ended December 31, 2015 and 2014 and was $89,000 for the year ended December 31, 2013. Benefits paid to former executives of SNB under this plan totaled $0, $83,000 and $67,000 for the years ended December 31, 2015, 2014 and 2013, respectively. Certain officers of the Company have supplemental life insurance policies with death benefits available to the officers' beneficiaries.

In connection with these plans the Company has purchased, or acquired through the merger, single premium life insurance policies with cash surrender values totaling $39,275,000 and $38,303,000 at December 31, 2015 and 2014, respectively.

Officer and Director Deferred Compensation Plan

The Company has established a deferred compensation plan for certain members of the management group and a deferred fee plan for directors for the purpose of providing the opportunity for participants to defer compensation. The Company bears the costs for the plan's administration and the interest earned on participant deferrals. The related administrative expense was not material for the years ended December 31, 2015, 2014 and 2013. In connection with this plan, life insurance policies with cash surrender values totaling $4,865,000 and $4,686,000 at December 31, 2015 and2014, respectively, are included on the consolidated balance sheet in other assets.

<u>401(k) Savings Plan</u>

The 401(k) savings plan (the "Plan") allows participants to defer, on a pre-tax basis, up to 15% of their salary (subject to Internal Revenue Service limitations) and accumulate tax-deferred earnings as a retirement fund. The Bank may make a discretionary contribution to match a specified percentage of the first 6% of the participants' contributions annually. The amount of the matching contribution was 75%, for both of the years ended December 21, 2015 and 2014, and 60% for the year ended December 31, 2013. The matching contribution is discretionary, vests over a period of five years from the participants' hire date, and is subject to the approval of the Board of Directors. The Company contributed $543,000, $477,000, and $360,000 to the Plan in 2015, 2014 and 2013, respectively.

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

16. NON-INTEREST REVENUE

The major grouping of non-interest revenue on the consolidated income statements includes several specific items: service charges on deposit accounts, gains on the sale of loans, credit card fees, check card fees, the net gain (loss) on sales and calls of investment securities available for sale, and the net increase (decrease) in the cash surrender value of life insurance.

Non-interest revenue also includes one general category of “other income” of which the following are major components (dollars in thousands):

	Year Ended December 31,		
	2015	2014	2013
Included in other income:			
Loss on limited partnerships	$(1,058)	$(1,161)	$(1,063)
Dividends on Equity Investments	838	453	356
Rental income on leases	-	-	46
Other	2,260	1,957	2,569
Total other non-interest income	$2,040	$1,249	$1,908

17. OTHER NON-INTEREST EXPENSE

Other non-interest expense consisted of the following (dollars in thousands):

	Year Ended December 31,		
	2015	2014	2013
Professional fees	$3,122	$3,354	$4,143
Data processing	3,426	2,716	1,562

Advertising and promotion	2,319	2,205	1,960
Deposit services	3,182	2,587	2,405
Stationery and supplies	1,296	1,192	657
Telephone and data communication	1,857	1,283	1,613
Loan and credit card processing	891	1,113	999
Foreclosed assets (income) expense, net	153	(1,420)	1,529
Postage	923	775	713
Other	1,663	1,230	1,040
Total other non-interest expense	$18,832	$15,035	$16,621

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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18. RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank enters into loans with related parties, including executive officers and directors. These loans are made with substantially the same terms, including rates and collateral, as loans to unrelated parties. The following is a summary of the aggregate activity involving related party borrowers (dollars in thousands):

	Year Ended December 31,		
	2015	2014	2013
Balance, beginning of year	$3,188	$3,742	$3,719
Disbursements	5,652	11,850	1,143
Amounts repaid	(6,056)	(12,404)	(1,120)
Balance, end of year	$2,784	$3,188	$3,742
Undisbursed commitments to related parties	$2,121	$2,272	$1,871

Deposits from related parties held by the Bank at December 31, 2015 and 2014 amounted to $6,464,000 and $6,283,000, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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19. FAIR VALUE

Fair value is defined by U.S. GAAP 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. U.S. GAAP also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

§ 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 use in pricing an asset or liability.

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

19. FAIR VALUE (Continued)

The Company used the following methods and significant assumptions to estimate fair values for each category of financial asset noted below:

Securities: The fair values of securities available for sale 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: A specific loss allowance is created for collateral dependent impaired loans, representing the difference between the face value of the loan and its current appraised value less estimated disposition costs.

Foreclosed assets: Repossessed real estate (OREO) and other 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 for all other assets fair value is represented by the 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.

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

19. FAIR VALUE (Continued)

Assets and liabilities measured at fair value on a recurring basis, including financial liabilities for which the Company has elected the fair value option, are summarized below (dollars in thousands):

	Fair Value Measurements at December 31, 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)**
Securities:					
US Government Agencies	$ -	$ 29,042	$ -	$ 29,042	$ -
Mortgage-backed securities	-	375,061	-	375,061	-
State and political subdivisions	-	102,183	-	102,183	-
Equity securities	1,296	-	-	1,296	-
Total available-for-sale securities	$ 1,296	$ 506,286	$ -	$ 507,582	$ -

	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)**

Securities:					
US Government Agencies	$-	$ 27,270	$ -	$27,270	$ -
Mortgage-backed securities	-	381,442	-	381,442	-
State and political subdivisions	-	100,949	-	100,949	-
Equity securities	2,222	-	-	2,222	-
Total available-for-sale securities	$2,222	$ 509,661	$ -	$511,883	$ -

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SIERRA BANCORP AND SUBSIDIARY

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19. FAIR VALUE (Continued)

Assets and liabilities measured at fair market value on a non-recurring basis are summarized below (dollars in thousands):

	Year Ended December 31, 2015			
	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	$-	$ 3,829	$ -	$3,829
Foreclosed assets	$-	$ 3,193	$ -	$3,193

	Year Ended December 31, 2014			
	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

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Explanation of Responses:

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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20. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

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

Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the fair values presented. The following methods and assumptions were used by the Company to estimate the fair value of its financial instruments at December 31, 2015 and 2014:

Cash and cash equivalents, and fed funds sold: For cash and cash equivalents and fed funds sold, the carrying amount is estimated to be fair value.

Securities: The fair values of investment securities 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.

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 thus not relevant for reporting purposes. If available-for-sale loans stay on our books for an extended period of time, the fair value of those loans is determined using quoted secondary-market prices.

Cash surrender value of life insurance policies: The fair values are based on current cash surrender values at each reporting date provided by the insurers.

Investment in limited partnerships: The fair values of our investments in limited partnerships are estimated using quarterly indications of value provided by the general partner. The fair values of undisbursed capital commitments are assumed to be the same as their book values.

Other investments: Included in other assets are certain long-term investments carried at cost, which approximates 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.

Short-term borrowings: The carrying amounts approximate fair values for federal funds purchased, overnight FHLB advances, 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.

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

20. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

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

Subordinated debentures: The fair values of subordinated debentures 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 approximate 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.

Carrying amount and estimated fair values of financial instruments were as follows (dollars in thousands):

	Year Ended December 31, 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	$48,623	$48,623	$ -	$ -	$48,623
Securities available for sale	507,582	1,296	506,286	-	507,582
Loans and leases held for investment	1,120,773	-	1,136,386	-	1,136,386
Collateral dependent impaired loans	3,829	-	3,829	-	3,829

Cash surrender value of life insurance policies	44,140	-	44,140		-	44,140
Other investments	7,546	-	7,546		-	7,546
Investment in limited partnership	6,217	-	6,217		-	6,217
Accrued interest receivable	5,808	-	5,808		-	5,808
Financial Liabilities:						
Deposits:						
Noninterest-bearing	$432,251	$432,251	$ -	$	-	$432,251
Interest-bearing	1,032,377	-	1,032,547		-	1,032,547
Fed funds purchased and Repurchase agreements	9,405	-	9,405		-	9,405
Short-term borrowings	75,300	-	75,300		-	75,300
Long-term borrowings	2,000	-	2,001		-	2,001
Subordinated debentures	30,928	-	7,383		-	7,383
Limited partnership capital commitment	795	-	795		-	795
Accrued Interest Payable	116	-	116		-	116

	Notional Amount
Off-balance-sheet financial instruments:	
Commitments to extend credit	$ 354,890
Standby letters of credit	16,654

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SIERRA BANCORP AND SUBSIDIARY

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(Continued)

20. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Carrying amount and estimated fair values of financial instruments were as follows (dollars in thousands):

	Year Ended December 31, 2014				
		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	$50,095	$50,095	$ -	$ -	$50,095
Securities available for sale	511,883	2,222	509,661	-	511,883
Loans and leases 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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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21. BUSINESS COMBINATION

On November 14, 2014, the Company acquired 100% of the outstanding common and preferred shares of Santa Clara Valley Bank (SCVB) in exchange for $15,300,000. Under the terms of the acquisition, SCVB common shareholders received $12,300,000 or $6.00 per share and SCVB preferred shareholders received $3,000,000 to retire outstanding preferred stock and associated warrants. Included in the $12,300,000 was $700,000 which the Company paid to cash out existing in-the-money warrants. SCVB results of operations were included in the Company’s results beginning November 14, 2014. Acquisition related costs of $101,000 and $2,070,000 are included in other operating expense in the Company’s income statement for the years ended December 31, 2015 and 2014.

In accordance with GAAP, the Company recorded $1,364,000 of goodwill and $1,075,000 of core deposit intangibles. Goodwill represents the excess of the consideration transferred (cash) at the acquisition date over the fair values of the identifiable net assets acquired. The core deposit intangible is being amortized using a straight line basis over eight years. For tax purposes goodwill and core deposit intangibles are both non-deductible.

The acquisition has provided the Company an opportunity to expand its market presence further south into the Santa Clara Valley. Synergies and cost savings resulting from the combined operations along with the introduction of the Company’s existing products and services into the new region have provided growth opportunities and the potential to increase profitability.

The following table summarizes the consideration paid for SCVB and the amounts of the assets acquired and liabilities assumed recognized at the acquisition date (dollars in thousands):

Consideration	
Cash	$15,338
Equity Instruments	-
Contingent Consideration	-
Fair value of total consideration transferred	$15,338
Recognized amounts of identifiable assets acquired and liabilities assumed	

Cash and cash equivalents	$15,852
Securities	44,187
Federal Home Loan Bank stock	860
Loans	61,573
Premises and equipment	1,188
Core deposit intangibles	1,075
Other assets	5,719
Total assets acquired	130,454
Deposits	108,272
Federal Home Loan Bank advances	8,000
Other liabilities	208
Total liabilities assumed	116,480
Total identifiable net assets	13,974
Goodwill	1,364
	$15,338

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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21. BUSINESS COMBINATION (Continued)

In many cases, the fair values of assets acquired and liabilities assumed were determined by estimating the cash flows expected to result from those assets and liabilities and discounting them at appropriate market rates. The most significant category of assets for which this procedure was used was that of acquired loans. The excess of expected cash flows above the fair value of the majority of loans will be accreted to interest income over the remaining lives of the loans in accordance with FASB Accounting Standards Codification (ASC) 310-20 (formerly SFAS 91). The Company believes that all contractual cash flows related to these loans will be collected. As such, these loans were not considered impaired at the acquisition date and were not subject to the guidance relating to purchased credit impaired loans, which have shown evidence of credit deterioration since origination. Loans acquired that were not subject to these requirements had a fair value and gross contractual amounts receivable of $61,345,000 and $71,470,000 as of the date of acquisition.

Certain loans, for which specific credit-related deterioration, since origination, was identified, are recorded at fair value, reflecting the present value of the amounts expected to be collected. Income recognition on these “purchase credit-impaired” loans is based on a reasonable expectation about the timing and amount of cash flows to be collected. Acquired loans deemed impaired and considered collateral dependent, with the timing of the sale of loan collateral indeterminate, remain on non-accrual status and have no accretable yield. These loans are discussed in further detail in Note 4 *Purchased Credit Impaired Loans.*

In accordance with GAAP, there was no carryover of the allowance for loan losses that had been previously recorded by SCVB.

The Company recorded a deferred income tax asset of $2,300,000 related to SCVB’s net operating loss carry-forward, as well as other tax attributes of SCVB, along with the effects of fair value adjustments resulting from applying the acquisition method of accounting.

The fair value of savings and transaction deposit accounts acquired from SCVB were assumed to approximate their carry value, as these accounts have no stated maturity and are payable on demand.

The following table presents unaudited pro forma information as if the acquisition had occurred at the beginning of 2013. The unaudited pro forma information included adjustments for interest income on loans and securities acquired, amortization of intangibles arising from the transaction, depreciation expense on property acquired, interest expense on deposits acquired, and the related income tax effects. The unaudited pro forma financial information is not necessarily indicative of the results of operations that would have occurred had the transactions been effected on the assumed dates (dollars in thousands):

	Pro Forma Year Ended **2014**	Pro Forma Year Ended **2013**
Net interest Income	$56,095	$53,189
Net income	$13,792	$13,082
Basic earnings per share	$0.99	$0.92
Diluted earnings per share	$0.98	$0.92

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

22. QUALIFIED AFFORDABLE HOUSING PROJECT INVESTMENTS

The Company invests in qualified affordable housing projects. At December 31, 2015 and 2014, the balance of the investment for qualified affordable housing projects totaled $4,900,000 and $5,800,000, respectively. These balances are reflected in the other assets line on the consolidated balance sheet. There were no unfunded commitments related to these investments in qualified affordable housing projects at December 31, 2015 and 2014.

During the year ended December 31, 2015 and 2014, the Company recognized amortization expense of $900,000 and $1,200,000, respectively, which was included within pretax income on the consolidated statements of income.

Additionally, during the years ended December 31, 2015 and 2014, the Company recognized tax credits and other benefits from its investment in affordable housing tax credits of $770,000 and $1,000,000, respectively. The Company had no impairment losses during the years ended December 31, 2015 and 2014.

23. SUBSEQUENT EVENT

In January 2016 the Company entered into a definitive agreement to acquire Coast Bancorp, the holding company for Coast National Bank, which as of December 31, 2015 had $145,000,000 in total assets, $94,000,000 in loans, $24,000,000 in investment securities, and $127,000,000 in deposits. Coast maintains offices in San Luis Obispo, Paso Robles, Arroyo Grande, and Atascadero, California. We expect the transaction to be completed in the second quarter of 2016, subject to customary closing conditions including the receipt of required regulatory approvals and the consent of Coast Bancorp shareholders. One-time acquisition costs are expected to add roughly $3,200,000 to the Company’s pre-tax non-interest expense in 2016. Also announced in January 2016 was the Company’s agreement to acquire the Porterville branch of Citizens Business Bank, including approximately $22,000,000 in deposits and $1,000,000 in loans which we plan to consolidate into our Porterville Main office. Pending regulatory approval, that transaction is also scheduled for completion in the second quarter of 2016.

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

24. PARENT ONLY CONDENSED FINANCIAL STATEMENTS

BALANCE SHEETS

Years Ended December 31, 2015 and 2014

(dollars in thousands)

	2015	2014
ASSETS		
Cash and due from banks	$2,222	$2,801
Investments in bank subsidiary	217,442	212,719
Investment in Trust subsidiaries	928	928
Investment in other securities	1,264	2,193
Other assets	13	14
	$221,869	$218,655
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Other liabilities	$601	$636
Subordinated debentures	30,928	30,928
Total liabilities	31,529	31,564
Shareholders' equity:		
Common stock	65,093	66,758
Retained Earnings	122,701	116,026
Accumulated other comprehensive income, net of taxes	2,546	4,307
Total shareholders' equity	190,340	187,091
	$221,869	$218,655

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

24. PARENT ONLY CONDENSED FINANCIAL STATEMENTS (Continued)

STATEMENTS OF INCOME

Years Ended December 31, 2015, 2014 and 2013

(dollars in thousands)

	2015	2014	2013
Income:			
Dividend from Subsidiary	$12,500	$15,500	$3,000
Gain on sale of securities	506	238	-
Other operating income	19	80	16
Total Income	13,025	15,818	3,016
Expense			
Salaries and employee benefits	365	347	349
Other expenses	1,344	1,195	1,313
Total expenses	1,709	1,542	1,662
Income before income taxes	11,316	14,276	1,354
Income tax benefit	(502)	(690)	(803)
Income (loss) before equity in undistributed income of subsidiary	11,818	14,966	2,157
Equity in undistributed income of subsidiary	6,249	274	11,212
Net income	$18,067	$15,240	$13,369

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SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

24. PARENT ONLY CONDENSED FINANCIAL STATEMENTS (Continued)

STATEMENTS OF CASH FLOWS

Years Ended December 31, 2015, 2014 and 2013

(dollars in thousands)

	2015	2014	2013
Cash flows from operating activities:			
Net Income	$18,067	$15,240	$13,369
Adjustments to reconcile net income to net cash provided by operating activities:			
Undistributed net income of subsidiary	(6,249)	(274)	(11,212)
Gain on sale of securities	(506)	(238)	-
Decrease (increase) in other assets	-	325	(75)
Increase (decrease) in other liabilities	96	(71)	106
Tax benefit from equity based compensation	-	-	29
Net cash provided for operating activities	11,408	14,982	2,217
Cash flows from investing activities:			
Purchases of securities	-	(37)	-
Sales of securities	1,104	402	-
Net cash provided by investing activities	1,104	365	-
Cash flows from financing activities:			
Stock options exercised	526	1,075	1,088
Repurchase of common stock	(7,955)	(10,183)	-
Dividends paid	(5,662)	(4,775)	(3,680)
Net cash used in by financing activities	(13,091)	(13,883)	(2,592)
Net decrease (increase) in cash and cash equivalents	(579)	1,464	(375)
Cash and cash equivalents, beginning of year	2,801	1,337	1,712
Cash and cash equivalents, end of year	$2,222	$2,801	$1,337

SIERRA BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

25. CONDENSED QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following table sets forth the Company's unaudited results of operations for the four quarters of 2015 and 2014. In management's opinion, the results of operations reflect all adjustments (which include only recurring adjustments) necessary to present fairly the condensed results for such periods (dollars in thousands, except per share data).

	2015 Quarter Ended			
	December 31,	September 30,	June 30,	March 31,
Interest income	$16,163	$ 15,524	$15,669	$15,351
Interest expense	650	647	651	633
Net interest income	15,513	14,877	15,018	14,718
Provision for loan and lease losses	-	-	-	-
Non-interest income	4,793	4,261	4,654	4,007
Non-interest expense	12,207	12,285	12,751	13,460
Net income before taxes	8,099	6,853	6,921	5,265
Provision for taxes	2,737	2,443	2,364	1,527
Net income	$5,362	$ 4,410	$4,557	$3,738
Diluted earnings per share	$.40	$ .33	$.33	$.27
Cash dividend per share	$.11	$ .11	$.10	$.10

	2014 Quarter Ended			
	December 31,	September 30,	June 30,	March 31,
Interest income	$14,509	$ 13,978	$13,682	$12,952
Interest expense	641	686	732	737
Net interest income	13,868	13,292	12,950	12,215
Provision for loan and lease losses	-	-	200	150
Non-interest income	4,321	3,785	4,018	3,707
Non-interest expense	12,889	11,750	11,008	10,728

Net income before taxes	5,300	5,327	5,760	5,044
Provision for taxes	1,647	1,776	1,523	1,245
Net income	$3,653	$ 3,551	$4,237	$3,799
Diluted earnings per share	$.26	$ .25	$.31	$.26
Cash dividend per share	$.09	$ .09	$.08	$.08

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Item 9. Changes in and Disagreements with Accountants on Accounting And Financial Disclosure

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company's Chief Executive Officer and its Chief Financial Officer, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13(a)–15(e) as of the end of the period covered by this report (the "Evaluation Date") have concluded that as of the Evaluation Date, the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company and its consolidated subsidiaries would be made known to them by others within those entities, particularly during the period in which this annual report was being prepared.

Disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure, and that such information is recorded, processed, summarized, and reported within the time periods specified by the SEC.

Management's Report on Internal Control over Financial Reporting

Management of the Company is responsible for the preparation, integrity, and reliability of the consolidated financial statements and related financial information contained in this annual report. The consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America and, as such, include some amounts that are based on judgments and estimates of management.

Management has established and is responsible for maintaining effective internal control over financial reporting. The Company's internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

There are inherent limitations in the effectiveness of any internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even effective internal control can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of internal control may vary over time. The system contains monitoring mechanisms, and actions are taken to correct deficiencies identified.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2015. This assessment was based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. This assessment included controls over the preparation of regulatory financial statements in accordance with the Federal Financial Institutions Examination Council's Instructions for Preparation of Consolidated Reports of Condition and Income, and in accordance with the Board of Governors of the Federal Reserve System's Instructions for Preparation of Financial Statements for Bank Holding Companies (Consolidated and Parent Company Only). Based on this assessment, management believes that the Company maintained effective internal control over financial reporting as of December 31, 2015.

Management is responsible for compliance with the federal and state laws and regulations concerning dividend restrictions and federal laws and regulations concerning loans to insiders designated by the FDIC as safety and soundness laws and regulations. Management assessed compliance by the Company's insured financial institution, Bank of the Sierra, with the designated laws and regulations relating to safety and soundness. Based on this assessment, management believes that Bank of the Sierra complied, in all significant respects, with the designated laws and regulations related to safety and soundness for the year ended December 31, 2015.

Our assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2015 has been audited by Vavrinek, Trine, Day & Co., LLP, an independent registered public accounting firm, as stated in their report appearing below.

Changes in Internal Control

There were no significant changes in the Company's internal control over financial reporting or in other factors in the fourth quarter of 2015 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders

Sierra Bancorp and Subsidiary

Porterville, California

We have audited Sierra Bancorp and Subsidiary's (the Company's) internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. Because management's assessment and our audit were conducted to also meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), management's assessment and our audit of the Company's internal control over financial reporting included controls over the preparation of financial statements in accordance with instructions to the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C). A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and the receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board, the consolidated balance sheets of the Company as of December 31, 2015 and 2014, and the related consolidated statements of income, shareholders' equity and comprehensive income and cash flows for each of the years in the three year period ended December 31, 2015, and our report dated March 11, 2016 expressed an unqualified opinion on those financial statements.

/s/ Vavrinek, Trine, Day & Co., LLP

Rancho Cucamonga, California

March 11, 2016

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ITEM 9B. OTHER INFORMATION.

None.

PART III

Item 10. Directors, Executive Officers AND CORPORATE GOVERNANCE

The information required to be furnished pursuant to this item with respect to Directors and Executive Officers of the Company will be set forth under the caption “Election of Directors” in the Company’s proxy statement for the 2016 Annual Meeting of Shareholders (the “Proxy Statement”), which the Company will file with the SEC within 120 days after the close of the Company’s 2015 fiscal year in accordance with SEC Regulation 14A under the Securities Exchange Act of 1934. Such information is hereby incorporated by reference.

The information required to be furnished pursuant to this item with respect to compliance with Section 16(a) of the Exchange Act will be set forth under the caption “Section 16(a) Beneficial Ownership Reporting Compliance” in the Proxy Statement, and is incorporated herein by reference.

The information required to be furnished pursuant to this item with respect to the Company’s Code of Ethics and corporate governance matters will be set forth under the caption “Corporate Governance” in the Proxy Statement, and is incorporated herein by reference.

Item 11. Executive Compensation

The information required to be furnished pursuant to this item will be set forth under the captions “Executive Officer and Director Compensation” and “Compensation Discussion and Analysis” in the Proxy Statement, and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management AND RELATED SHAREHOLDER MATTERS

Securities Authorized for Issuance under Equity Compensation Plans

The information required by Item 12 with respect to securities authorized for issuance under equity compensation plans is set forth under “Item 5 – Market for Registrant’s Common Equity and Issuer Repurchases of Equity Securities” above.

Other Information Concerning Security Ownership of Certain Beneficial Owners and Management

The remainder of the information required by Item 12 will be set forth under the captions “Security Ownership of Certain Beneficial Owners and Management” and “Election of Directors” in the Proxy Statement, and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions AND DIRECTOR INDEPENDENCE

The information required to be furnished pursuant to this item will be set forth under the captions “Related Party Transactions” and “Corporate Governance – Director Independence” in the Proxy Statement, and is incorporated herein by reference.

Item 14. PRINCIPAL ACCOUNTING FEES and SERVICES

The information required to be furnished pursuant to this item will be set forth under the caption “Ratification of Appointment of Independent Registered Public Accounting Firm – Fees” in the Proxy Statement, and is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(a) **Exhibits**

Exhibit #	Description
2.1	Agreement and Plan of Consolidation by and among Sierra Bancorp, Bank of the Sierra and Santa Clara Valley Bank, N.A., dated as of July 17, 2014 (1)
2.2	Agreement and Plan of Reorganization and Merger, dated as of January 4, 2016 by and between Sierra Bancorp and Coast Bancorp (2)
3.1	Restated Articles of Incorporation of Sierra Bancorp (3)
3.2	Amended and Restated By-laws of Sierra Bancorp (4)
10.1	1998 Stock Option Plan (5)
10.2	Salary Continuation Agreement for Kenneth R. Taylor (6)
10.3	Salary Continuation Agreement for James C. Holly (6)
10.4	Salary Continuation Agreement and Split Dollar Agreement for James F. Gardunio (7)
10.5	Split Dollar Agreement for Kenneth R. Taylor (8)
10.6	Split Dollar Agreement and Amendment thereto for James C. Holly (8)
10.7	Director Retirement Agreement and Split dollar Agreement for Vincent Jurkovich (8)
10.8	Director Retirement Agreement and Split dollar Agreement for Robert Fields (8)
10.9	Director Retirement Agreement and Split dollar Agreement for Gordon Woods (8)
10.10	Director Retirement Agreement and Split dollar Agreement for Morris Tharp (8)
10.11	Director Retirement Agreement and Split dollar Agreement for Albert Berra (8)
10.12	401 Plus Non-Qualified Deferred Compensation Plan (8)
10.13	Indenture dated as of March 17, 2004 between U.S. Bank N.A., as Trustee, and Sierra Bancorp, as Issuer (9)
10.14	Amended and Restated Declaration of Trust of Sierra Statutory Trust II, dated as of March 17, 2004 (9)
10.15	Guarantee Agreement between Sierra Bancorp and U.S. Bank National Association dated as of March 17, 2004 (9)
10.16	Indenture dated as of June 15, 2006 between Wilmington Trust Co., as Trustee, and Sierra Bancorp, as Issuer (10)
10.17	Amended and Restated Declaration of Trust of Sierra Capital Trust III, dated as of June 15, 2006 (10)
10.18	Guarantee Agreement between Sierra Bancorp and Wilmington Trust Company dated as of June 15, 2006 (10)
10.19	2007 Stock Incentive Plan (11)
10.20	Sample Retirement Agreement Entered into with Each Non-Employee Director Effective January 1, 2007 (12)
10.21	Salary Continuation Agreement for Kevin J. McPhaill (12)
10.22	First Amendment to the Salary Continuation Agreement for Kenneth R. Taylor (12)
10.23	Second Amendment to the Salary Continuation Agreement for Kenneth R. Taylor (13)

10.24	First Amendment to the Salary Continuation Agreement for Kevin J. McPhaill (14)
11	Statement of Computation of Per Share Earnings (15)
21	Subsidiaries of Sierra Bancorp (16)
23	Consent of Vavrinek, Trine, Day & Co., LLP
31.1	Certification of Chief Executive Officer (Section 302 Certification)
31.2	Certification of Chief Financial Officer (Section 302 Certification)
32	Certification of Periodic Financial Report (Section 906 Certification)
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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(1) Filed as an Exhibit to the Form 8-K filed with the SEC on July 18, 2014 and incorporated herein by reference.
(2) Filed as an Exhibit to the Form 8-K filed with the SEC on January 5, 2016 and incorporated herein by reference.
(3) Filed as Exhibit 3.1 to the Form 10-Q filed with the SEC on August 7, 2009 and incorporated herein by reference.
(4) Filed as an Exhibit to the Form 8-K filed with the SEC on February 21, 2007 and incorporated herein by reference.
(5) Filed as Exhibit 10.1 to the Registration Statement of Sierra Bancorp on Form S-4 filed with the Securities and Exchange Commission (SEC) (Registration No. 333-53178) on January 4, 2001 and incorporated herein by reference.
(6) Filed as Exhibits 10.5 and 10.7 to the Form 10-Q filed with the SEC on May 15, 2003 and incorporated herein by reference.
(7) Filed as an Exhibit to the Form 8-K filed with the SEC on August 11, 2005 and incorporated herein by reference.
(8) Filed as Exhibits 10.10, 10.12, and 10.15 through 10.20 to the Form 10-K filed with the SEC on March 15, 2006 and incorporated herein by reference.
(9) Filed as Exhibits 10.9 through 10.11 to the Form 10-Q filed with the SEC on May 14, 2004 and incorporated herein by reference.
(10) Filed as Exhibits 10.26 through 10.28 to the Form 10-Q filed with the SEC on August 9, 2006 and incorporated herein by reference.
(11) Filed as Exhibit 10.20 to the Form 10-K filed with the SEC on March 15, 2007 and incorporated herein by reference.
(12) Filed as an Exhibit to the Form 8-K filed with the SEC on January 8, 2007 and incorporated herein by reference.
(13) Filed as Exhibit 10.23 to the Form 10-K filed with the SEC on March 13, 2014 and incorporated herein by reference.
(14) Filed as Exhibit 10.24 to the Form 10-Q filed with the SEC on May 7, 2015 and incorporated herein by reference.
(15) Computation of earnings per share is incorporated by reference to Note 6 to the Financial Statements included herein.
(16) Filed as Exhibit 21 to the Form 10-K filed with the SEC on March 15, 2007 and incorporated herein by reference.

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(b) **Financial Statement Schedules**

Schedules to the financial statements are omitted because the required information is not applicable or because the required information is presented in the Company’s Consolidated Financial Statements or related notes.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: March 11, 2016 **SIERRA BANCORP,**
a California corporation

By: */s/ Kevin J. McPhaill*
Kevin J. McPhaill
President &
Chief Executive Officer
(Principal Executive Officer)

By: */s/ Kenneth R. Taylor*
Kenneth R. Taylor
Executive Vice President &
Chief Financial Officer
(Principal Financial and Principal Accounting Officer)

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

Signature	Title	Date
/s/ Albert L. Berra Albert L. Berra	Director	March 11, 2016
/s/ Robert L. Fields Robert L. Fields	Director	March 11, 2016
/s/ James C. Holly James C. Holly	Vice Chairman of the Board	March 11, 2016
/s/ Kevin J. McPhaill Kevin J. McPhaill	President, Chief Executive Officer & Director (Principal Executive Officer)	March 11, 2016
/s/ Lynda B. Scearcy Lynda B. Scearcy	Director	March 11, 2016

/s/ Morris A. Tharp Morris A. Tharp	Chairman of the Board	March 11, 2016
/s/ Gordon T. Woods Gordon T. Woods	Director	March 11, 2016
/s/ Kenneth R. Taylor Kenneth R. Taylor	Executive Vice President & Chief Financial Officer (Principal Financial and Principal Accounting Officer)	March 11, 2016

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