CENTRAL VALLEY COMMUNITY BANCORP
Form 10-K
March 21, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2013
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number: 000-31977
CENTRAL VALLEY COMMUNITY BANCORP
(Exact name of registrant as specified in its charter)

CALIFORNIA	77-0539125
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
7100 N. Financial Dr., Suite 101, Fresno, CA	93720
(Address of principal executive offices)	(Zip Code)

559-298-1775
(Registrant’s telephone number, including area code)
[None]
(Former name, former address and former fiscal year, if changed since last report)
Securities registered pursuant to Section 12(b) of the Act:

None	NASDAQ Capital Market
[Common Stock, $ par value per share]	[EXCHANGE]

Securities registered pursuant to Section 12(g) of the Act: Common Stock, No Par Value
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No x
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

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

As of June 30, 2013, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was $66,029,000 based on the price at which the stock was last sold on June 30, 2013.

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

Common Stock, No Par Value	Outstanding at March 21, 2014	
[Common Stock, No par value per share]	10,925,085	shares

DOCUMENTS INCORPORATED BY REFERENCE

Document	Parts into Which Incorporated
Proxy Statement for the Annual Meeting of Shareholders to be held May 21, 2014 (Proxy Statement)	Part III

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ADDITIONAL INFORMATION; INQUIRIES

Under the Securities Exchange Act of 1934, Sections 13 and 15(d), periodic and current reports must be filed with the SEC. We electronically file the following reports with the SEC:

•Form 10-K — Annual Report;
•Form 10-Q — Quarterly Report;
•Form 8-K — Report of Unscheduled Material Events; and
•Form DEF 14A — Proxy Statement.

We may file additional forms. The SEC maintains an Internet site, www.sec.gov, in which all forms filed electronically may be accessed. Additional shareholder information regarding the Company and our Directors is available on our website: www.cvcb.com. None of the information on or hyperlinked from our website is incorporated into this Report.
Copies of the annual report on Form 10-K for the year ended December 31, 2013 may be obtained without charge upon written request to Dave Kinross, Chief Financial Officer, at the Company's administrative offices, 7100 N. Financial Dr., Suite 101, Fresno, CA 93720.
Inquiries regarding Central Valley Community Bancorp's accounting, internal controls or auditing concerns should be directed to Steven D. McDonald, chairman of the Board of Directors' Audit Committee, at steve.mcdonald@cvcb.com or anonymously at www.ethicspoint.com or EthicsPoint, Inc. at 1-866-294-9588.
General inquiries about Central Valley Community Bancorp or Central Valley Community Bank should be directed to Cathy Ponte, Assistant Corporate Secretary at 1-800-298-1775.

PART I

ITEM 1 - DESCRIPTION OF BUSINESS

General

Central Valley Community Bancorp (the Company) was incorporated on February 7, 2000 as a California corporation, for the purpose of becoming the holding company for Central Valley Community Bank (the Bank), formerly known as Clovis Community Bank, a California state chartered bank, through a corporate reorganization. In the reorganization, the Bank became the wholly-owned subsidiary of the Company, and the shareholders of the Bank became the shareholders of the Company. The Company is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended (the BHC Act), and is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the Board of Governors).
At December 31, 2013, we had one banking subsidiary, the Bank. Our principal business is to provide, through our banking subsidiary, financial services in our primary market area in California. We serve seven contiguous counties in California's central valley including Fresno County, Madera County, Merced County, Sacramento County, San Joaquin County, Stanislaus County, and Tulare County, and their surrounding areas through the Bank. We do not currently conduct any operations other than through the Bank. Unless the context otherwise requires, references to us refer to the Company and the Bank on a consolidated basis. At December 31, 2013, we had consolidated total assets of approximately $1,145,635,000. See Items 7 and 8, Management's Discussion and Analysis or Plan of Operation and Financial Statements.
Effective July 1, 2013, the Company and Visalia Community Bank (VCB) completed a merger under which Visalia Community Bank, with three full-service offices in Visalia and one in Exeter, merged with and into the Bank.
On August 18, 2011, the Company entered into a Securities Purchase Agreement (SPA) with the Small Business Lending Fund of the United States Department of the Treasury (the Treasury), under which the Company issued 7,000 shares of Senior Non-Cumulative Perpetual Preferred Stock, Series C (Series C Preferred) to the Treasury for an

aggregate purchase price of $7,000,000. Simultaneously, the Company agreed with Treasury under a Letter Agreement to redeem, for an aggregate price of $7,000,000, the 7,000 shares of the Company's Series A Fixed Rate Cumulative Preferred Stock (Series A Stock) originally issued pursuant to the Treasury's Capital Purchase Program (CPP) in 2009. The redemption of the Series A Stock resulted in an acceleration of the remaining discount booked at the time of the CPP transaction. In connection with the repurchase of the Series A Stock, the Company also repurchased the warrant (the Warrant) to purchase 79,037 shares of the Company's common stock that was originally issued to Treasury in connection with the CPP transaction for total consideration of $185,000.
On December 31, 2013, the Company redeemed all 7,000 outstanding shares of its Series C Preferred from the Treasury, in exercise of its optional redemption rights pursuant to the terms of the Series C Preferred under the Company's charter and the SPA. The Company paid the Treasury $7,087,500 in connection with the redemption, representing $1,000 per share of the Series C Preferred plus all accrued and unpaid dividends through the date of the redemption. The obligations of

the Company under the SPA are terminated as a result of the redemption. No additional shares of Series C Preferred are outstanding.

On December 23, 2009, the Company entered into Stock Purchase Agreements (Agreements) with a limited number of accredited investors (collectively, the Purchasers) to sell to the Purchasers a total of 1,264,952 shares of common stock, (Common Stock) at $5.25 per share and 1,359 shares of non-voting Series B Convertible Adjustable Rate Non-Cumulative Perpetual Preferred Stock (Series B Preferred Stock) at $1,000 per share, for an aggregate gross purchase price of $8,000,000 (the Offering) offset by issuance costs totaling $242,000.

In May 2010, the shareholders of the Company approved an amendment to the Company's governing instruments to create a series of non-voting common stock. In June 2010, the Company exercised its option to require the Purchasers to exchange the 1,359 shares of Series B Preferred Stock for 258,862 shares of non-voting common stock. In August, 2011, the Company agreed to exchange the 258,862 shares of the Company's non-voting common stock to 258,862 shares of the Company's voting common stock. The issuance of voting common stock was conducted in a privately negotiated transaction exempt from registration pursuant to Sections 3(a)(9) and 4(2) of the Securities Act of 1933, as amended. No shares of Series B Preferred Stock or non-voting common stock remain outstanding.

On August 15, 2012, the Board of Directors of the Company approved the adoption of a program to effect repurchases of the Company's common stock. Under the program, the Company was to repurchase up to five percent of the Company's outstanding shares of common stock, or approximately 479,850 shares based on the shares outstanding as of August 15, 2012, for the period beginning on August 15, 2012, and ending February 15, 2013. During 2012, the Company repurchased and retired a total of 58,100 shares at an average price of $8.41 for a total cost of $488,000. The stock repurchase program was suspended after the Company entered into the Merger Agreement with Visalia Community Bank on December 19, 2012. The Company had no stock repurchase plans in place during 2013 or 2011.

As of March 1, 2014, we had a total of 290 employees and 272 full time equivalent employees, including the employees of the Bank.

The Bank

The Bank was organized in 1979 and commenced business as a California state chartered bank in 1980. The deposits of the Bank are insured by the Federal Deposit Insurance Corporation (the FDIC) up to applicable limits. The Bank is not a member of the Federal Reserve System

The Bank operates 21 full-service banking offices in Clovis, Exeter, Fresno, Kerman, Lodi, Madera, Merced, Modesto, Oakhurst, Prather, Sacramento, Stockton, Tracy, and Visalia. The Oakhurst and Madera branches were added through the Bank of Madera County merger in 2005. The Tracy, Stockton and Lodi offices were added through the merger with Service 1st Bank in November of 2008. The Exeter and Visalia offices were added through the Visalia Community Bank merger in 2013. The Bank has a Real Estate Division, an Agribusiness Center and an SBA Lending Division in Fresno. All real estate related transactions are conducted and processed through the Real Estate Division, including interim construction loans for single family residences and commercial buildings. We offer permanent single family residential loans through our mortgage broker services. Our total market share of deposits in Fresno and Madera counties were 4.65% in 2013 compared to 4.81% in 2012 based on FDIC deposit market share information published as of June 30, 2013.

The Bank of Madera County (BMC) was merged with and into the Bank on January 1, 2005. The transaction was a combination of cash and stock and was accounted for under the purchase method of accounting. BMC had two branches in Madera County which continue to be operated by the Bank.

In November of 2008, The Company acquired Service 1st and its banking subsidiary, S1 Bank, adding three branches located in Tracy, Stockton and Lodi, California.

In 2009, we opened a new full service office in Merced, California and relocated our Oakhurst office to a new smaller facility in a more desirable location.

In 2010, the Company expanded the existing Modesto loan production office opened in 2007, to a larger full-service branch.

In 2013, the Company acquired Visalia Community Bank, adding four branches located in Exeter and Visalia, California.

Branch expansions provide the Company with opportunities to expand its loan and deposit base; however, based on past experience, management expects these new offices will initially have a negative impact on earnings until the volume of business grows to cover fixed overhead expenses. The Bank anticipates additional future branch openings to meet the growing service needs of its customers, although none are planned during 2014.

The Bank conducts a commercial banking business, which includes accepting demand, savings and time deposits and making commercial, real estate and consumer loans. It also provides domestic and international wire transfer services and provides safe deposit boxes and other customary banking services. The Bank also has offered Internet banking since 2000. Internet banking consists of inquiry, account status, bill paying, account transfers, and cash management. The Bank does not offer trust services or international banking services and does not currently plan to do so in the near future.

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The Bank established an interest in Central Valley Community Insurance Services, LLC at the end of 2006. The purpose of this entity is to market health, commercial property and casualty insurance products and services primarily to business customers.

Since August of 1995 the Bank has been a party to an agreement with Investment Centers of America, pursuant to which Investment Centers of America provides Bank customers with access to investment services. In connection with entering into this agreement, the Bank adopted a policy intended to comply with FDIC Regulation Section 337.4, which outlines the guidelines under which an insured non-member bank may be affiliated with a company that directly engages in the sale, distribution, or underwriting of stocks, bonds, debentures, notes, or other securities.

The Bank's operating policy since its inception has emphasized serving the banking needs of individuals and the business and professional communities in the central valley area of California. At December 31, 2013, we had total loans of $512,357,000. Total commercial and industrial loans outstanding were $87,082,000, total agricultural land and production loans outstanding were $31,649,000, total real estate construction and other land loans outstanding were $42,329,000; total other real estate loans outstanding were $291,610,000, total equity loans and lines of credit were $48,594,000 and total consumer installment loans outstanding were $11,252,000. We accept real estate, listed securities, savings and time deposits, automobiles, inventory, machinery and equipment as collateral for loans.

No individual or single group of related accounts is considered material in relation to the Bank's assets or deposits, or in relation to the overall business of the Company. However, at December 31, 2013 approximately 74.7% of our loan portfolio held for investment consisted of real estate-related loans, including construction loans, equity loans and lines of credit and commercial loans secured by real estate and 23.1% consisted of commercial loans. See Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations. We believe that these concentrations are mitigated by the diversification of our loan portfolio among commercial, real estate and consumer loans. In addition, our business activities currently are mainly concentrated in Fresno, Madera, Merced, Sacramento, San Joaquin, Stanislaus, and Tulare County, California. Consequently, our results of operations and financial condition are dependent upon the general trends in this part of the California economy and, in particular, the residential and commercial real estate markets. In addition, our concentration of operations in this area of California exposes us to greater risk than other banking companies with a wider geographic base in the event of catastrophes, such as earthquakes, fires, droughts, and floods in this region, or as a result of energy shortages in California.

Our deposits are attracted from individual and commercial customers. A material portion of our deposits have not been obtained from a single person or a few persons, the loss of any one or more of which would not have a material adverse effect on our business.

In order to attract loan and deposit business from individuals and small businesses, we maintain the following lobby hours at our branches:

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Branch	Monday — Thursday	Friday	Saturday
	9:00 a.m. to 4:00 p.m.	9:00 a.m. to 6:00 p.m.	
Clovis Main	Drive Up 8:00 a.m. to 5:30 p.m.	Drive Up 8:00 a.m. to 6:00 p.m.	None
	9:00 a.m. to 4:00 p.m.	9:00 a.m. to 5:00 p.m.	
Fresno Downtown	Walk-up window 8:00 a.m. to 9:00 a.m.	Walk-up window 8:00 a.m. to 9:00 a.m.	None
Fig Garden Village	9:00 a.m. to 5:00 p.m.	9:00 a.m. to 6:00 p.m.	10:00 a.m. to 2:00 p.m.
	9:00 a.m. to 5:00 p.m.	9:00 a.m. to 6:00 p.m.	9:00 a.m. to 2:00 p.m.
Herndon & Fowler	Drive Up 8:30 a.m. to 5:30 p.m.	Drive Up 8:30 a.m. to 6:00 p.m.	Drive Up 9:00 a.m. to 2:00 p.m.
	9:00 a.m. to 5:00 p.m.	9:00 a.m. to 6:00 p.m.	10:00 a.m. to 2:00 p.m.
River Park	Drive Up 9:00 a.m. to 5:30 p.m.	Drive Up 9:00 a.m. to 5:30 p.m.	Drive Up 10:00 a.m. to 2:00 p.m.
	9:00 a.m. to 5:00 p.m.	9:00 a.m. to 6:00 p.m.	
Sunnyside	Drive Up 8:30 a.m. to 5:00 p.m.	Drive Up 8:30 a.m. to 6:00 p.m.	None
	9:00 a.m. to 5:00 p.m.	9:00 a.m. to 6:00 p.m.	
Kerman	Drive Up 8:30 a.m. to 5:00 p.m.	Drive Up 8:30 a.m. to 6:00 p.m.	None
Lodi	9:00 a.m. to 5:00 p.m.	9:00 a.m. to 6:00 p.m.	None
Madera	8:30 a.m. to 5:00 p.m.	8:30 a.m. to 6:00 p.m.	None
Merced	9:00 a.m. to 5:00 p.m.	9:00 a.m. to 6:00 p.m.	None
	9:00 a.m. to 5:00 p.m.	9:00 a.m. to 6:00 p.m.	
Modesto	Drive Up 8:30 a.m. to 5:00 p.m.	Drive Up 8:30 a.m. to 6:00 p.m.	None
Oakhurst	8:30 a.m. to 5:00 p.m.	8:30 a.m. to 6:00 p.m.	None
Prather (Foothill office)	9:00 a.m. to 5:00 p.m.	9:00 a.m. to 6:00 p.m.	9:00 a.m. to 1:00 p.m.
Sacramento Private Banking	9:00 a.m. to 4:00 p.m.	9:00 a.m. to 4:00 p.m.	None
Stockton	9:00 a.m. to 5:00 p.m.	9:00 a.m. to 6:00 p.m.	None
Tracy	9:00 a.m. to 5:00 p.m.	9:00 a.m. to 6:00 p.m.	None
	9:00 a.m. to 5:00 p.m.	9:00 a.m. to 6:00 p.m.	
Exeter	Drive Up 8:30 a.m. to 5:30 p.m.	Drive Up 8:30 a.m. to 6:00 p.m.	None
	9:00 a.m. to 5:00 p.m.	9:00 a.m. to 6:00 p.m.	9:00 a.m. to 1:00 p.m.
Caldwell	Drive Up 8:30 a.m. to 5:30 p.m.	Drive Up 8:30 a.m. to 6:00 p.m.	Drive Up 9:00 a.m. to 1:00 p.m.
Floral	9:00 a.m. to 5:00 p.m.	9:00 a.m. to 6:00 p.m.	None

Mission Oaks	9:00 a.m. to 5:00 p.m. Drive Up 8:30 a.m. to 5:30 p.m.	9:00 a.m. to 6:00 p.m. Drive Up 8:30 a.m. to 6:00 p.m.	None
Mary's Vineyard Shopping Center	Walk-up and Drive-up ATMs only	Walk-up and Drive-up ATMs only	Walk-up and Drive-up ATMs only
Financial Drive	8:00 a.m. to 5:00 p.m.	8:00 a.m. to 5:00 p.m.	None

Automated teller machines operate at 21 branch locations. All operate 24 hours per day, seven days per week. No automated teller machines are currently located at the Sacramento office. Our Real Estate, Small Business Administration

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(SBA) Departments and Agribusiness office maintain business hours of 8:00 A.M. to 5:00 P.M., Monday through Friday, and extended hours are available upon customer request.

To compete effectively, we rely substantially on local promotional activity, personal contacts by our officers, directors and employees, referrals by our shareholders, extended hours, personalized service and our reputation in the communities we serve.

In Fresno and Madera Counties, in addition to our 12 full-service branch locations serving the Bank's primary service areas, as of June 30, 2013 there were 158 operating banking and credit union offices in our primary service area, which consists of the cities of Clovis, Fresno, Kerman, Oakhurst, Madera, and Prather, California. Prather does not contain any banking offices other than our office. The June 2013 FDIC Summary of Deposits report indicated the Company had 4.46% of the total deposits held by all depositories in Fresno County and 6.76% in Madera County. In San Joaquin County, in addition to our three full service branch locations, as of June 30, 2013 there were 111 operating banking and credit union offices. The FDIC Summary of Deposits as of June 2013 report indicated the Company had 1.69% of total deposits held by all depositories in San Joaquin County. In Merced County, in addition to our one branch, as of June 30, 2013 there were 31 operating banking and credit union offices in our primary service area. In Sacramento County, in addition to our one branch, as of June 30, 2013 there were 232 operating banking and credit union offices in our primary service area. In Stanislaus County, in addition to our one branch, there were 94 operating banking and credit union offices in our primary service area. In Tulare County, in addition to our four branches there were 61 operating banking and credit union offices in our primary service area. Business activity in our primary service area is oriented toward light industry, small business and agriculture.

The banking business in California generally, and our primary service area specifically, is highly competitive with respect to both loans and deposits, and is dominated by a relatively small number of major banks with many offices operating over a wide geographic area. Among the advantages such major banks have over us is their ability to finance wide-ranging advertising campaigns and to allocate their investment assets, including loans, to regions of higher yield and demand. Major banks offer certain services such as international banking and trust services which we do not offer directly but which we usually can offer indirectly through correspondent institutions. In addition, by virtue of their greater total capitalization, such banks have substantially higher lending limits than we do. Legal lending limits to an individual customer are limited to a percentage of our total capital accounts. As of December 31, 2013, the Bank's legal lending limits to individual customers were $14,346,000 for unsecured loans and $23,910,000 for unsecured and secured loans combined. For borrowers desiring loans in excess of the Bank's lending limits, the Bank makes, and may in the future make, such loans on a participation basis with other community banks taking the amount of loans in excess of the Bank's lending limits. In other cases, the Bank may refer such borrowers to larger banks or other lending institutions.

Other entities, both governmental and in private industry, seeking to raise capital through the issuance and sale of debt or equity securities also provide competition for us in the acquisition of deposits. Banks also compete with money market funds and other money market instruments, which are not subject to interest rate ceilings. In recent years, increased competition has also developed from specialized finance and non-finance companies that offer wholesale finance, credit card, and other consumer finance services, including on-line banking services and personal finance software. Competition for deposit and loan products remains strong, from both banking and non-banking firms, and affects the rates of those products as well as the terms on which they are offered to customers.

Technological innovation continues to contribute to greater competition in domestic and international financial services markets. Technological innovation has, for example, made it possible for non-depository institutions to offer customers automated transfer payment services that previously have been traditional banking products. In addition, customers now expect a choice of several delivery systems and channels, including telephone, mail, home computer, ATMs, remote deposit, mobile banking applications, self-service branches, and in-store branches.

Mergers between financial institutions have placed additional pressure on banks to streamline their operations, reduce expenses, and increase revenues to remain competitive. In addition, competition has intensified due to federal and state interstate banking laws, which permit banking organizations to expand geographically with fewer restrictions than in the past. Such laws allow banks to merge with other banks across state lines, thereby enabling banks to establish or expand banking operations in our market. The competitive environment also is significantly impacted by federal and state legislation, which may make it easier for non-bank financial institutions to compete with us.

Statistical Disclosure

The information in the tables set out below should be read in conjunction with the Company's audited consolidated financial statements and the notes thereto, and Management's Discussion and Analysis of Financial Condition and Results of Operations, which are included in Items 7 and 8 of this annual report.

Distribution of Average Assets, Liabilities and Shareholders' Equity; Interest Rates and Interest Differential

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Table A sets forth our average consolidated balance sheets for the years ended December 31, 2013, 2012, and 2011 and an analysis of interest rates and the interest rate differential for the years then ended. Table B sets forth the changes in interest income and interest expense in 2013 and 2012 resulting from changes in volume and changes in rates.

Investment Portfolio

The book value (amortized cost) of investment securities at December 31, 2013, 2012, and 2011 and the book value, maturities and weighted average yield of investment securities at December 31, 2013 are set forth in Table C.

Loan Portfolio

The composition of the loan portfolio at December 31, 2013, 2012, 2011, 2010, and 2009, is summarized in Table D. Maturities and sensitivity to changes in interest rates in the loan portfolio at December 31, 2013 are summarized in Table E. Table F shows the composition of nonaccrual, past due and restructured loans at December 31, 2013, 2012, 2011, 2010, and 2009. Set forth in the text accompanying Table F is a discussion of the Company’s policy for placing loans on nonaccrual status.

Summary of Loan Loss Experience

Table G sets forth an analysis of loan loss experience as of and for the years ended December 31, 2013, 2012, 2011, 2010, and 2009.
Set forth in the text accompanying Table G is a description of the factors which influenced management’s judgment in determining the amount of the additions to the allowance charged to operating expense in each fiscal year, a table showing the allocation of the allowance for credit losses to the various types of loans in the portfolio, as well as a discussion of management’s policy for establishing and maintaining the allowance for credit losses.

Deposits

Table H sets forth the average amount of and the average rate paid on major deposit categories for the years ended December 31, 2013, 2012, and 2011. Table I sets forth the maturity of time certificates of deposit of $100,000 or more at December 31, 2013.

Return on Equity and Assets

Table J sets forth certain financial ratios for the years ended December 31, 2013, 2012, and 2011.

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Table A

DISTRIBUTION OF AVERAGE ASSETS, LIABILITIES AND SHAREHOLDERS' EQUITY; INTEREST RATES AND INTEREST DIFFERENTIAL

The following table sets forth consolidated average assets, liabilities and shareholders' equity; interest income earned and interest expense paid; and the average yields earned or rates paid thereon for the years ended December 31, 2013, 2012, and 2011. The average balances reflect daily averages except nonaccrual loans, which were computed using quarterly averages.

	2013			2012			2011		
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Average Interest Rate	Average Balance	Interest Income/ Expense	Average Interest Rate	Average Balance	Interest Income/ Expense	Average Interest Rate
ASSETS:									
Interest-earning deposits in other banks	$46,672	$164	0.35 %	$36,836	$108	0.29 %	$73,016	$187	0.26 %
Securities:									
Taxable securities	235,487	2,375	1.01 %	218,325	3,289	1.51 %	150,559	4,548	3.02 %
Non-taxable securities (1)	163,494	8,755	5.35 %	113,039	6,830	6.04 %	75,665	5,248	6.94 %
Total investment securities	398,981	11,130	2.79 %	331,364	10,119	3.05 %	226,224	9,796	4.33 %
Federal funds sold	206	1	0.25 %	618	2	0.30 %	695	2	0.29 %
Total securities and interest-earning deposits	445,859	11,295	2.53 %	368,818	10,229	2.77 %	299,935	9,985	3.33 %
Loans (2)(3)	445,300	26,519	5.96 %	394,575	23,913	6.06 %	412,969	26,098	6.32 %
Federal Home Loan Bank stock	4,171	177	4.24 %	3,544	36	1.02 %	2,958	9	0.30 %
Total interest-earning assets (1)	895,330	$37,991	4.24 %	766,937	$34,178	4.46 %	715,862	$36,092	5.04 %
Allowance for credit losses	(9,713)			(10,365)			(11,018)		
Nonaccrual loans	9,183			10,465			15,322		
Other real estate owned	50			919			217		
Cash and due from banks	21,296			19,525			17,977		
Bank premises and equipment	7,816			6,217			5,788		
Other non-earning assets	62,962			59,380			56,030		
Total average assets	$986,924			$853,078			$800,178		

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(Dollars in thousands)	2013 Average Balance	Interest Income/ Expense	Average Interest Rate	2012 Average Balance	Interest Income/ Expense	Average Interest Rate	2011 Average Balance	Interest Income/ Expense	Average Interest Rate
LIABILITIES AND SHAREHOLDERS' EQUITY:									
Interest-bearing liabilities									
Interest-bearing deposits:									
Savings and NOW accounts	$215,668	$291	0.13 %	$177,205	$302	0.17 %	$154,765	$368	0.24 %
Money market accounts (MMA)	193,833	229	0.12 %	178,734	392	0.22 %	174,049	692	0.40 %
Time certificates of deposit, under $100,000	48,729	219	0.45 %	59,838	466	0.78 %	70,111	688	0.98 %
Time certificates of deposit, $100,000 and over	106,307	531	0.50 %	86,295	470	0.54 %	96,620	914	0.95 %
Total interest-bearing deposits	564,537	1,270	0.22 %	502,072	1,630	0.32 %	495,545	2,662	0.54 %
Other borrowed funds	5,645	116	2.05 %	9,156	253	2.76 %	10,265	280	2.73 %
Total interest-bearing liabilities	570,182	$1,386	0.24 %	511,228	$1,883	0.37 %	505,810	$2,942	0.58 %
Non-interest bearing demand deposits	283,956			217,529			182,244		
Other liabilities	13,040			9,760			8,738		
Shareholders' equity	119,746			114,561			103,386		
Total average liabilities and shareholders' equity	$986,924			$853,078			$800,178		
Interest income and rate earned on average earning assets (1)		$37,991	4.24 %		$34,178	4.46 %		$36,092	5.04 %
Interest expense and interest cost related to average interest-bearing liabilities		1,386	0.24 %		1,883	0.37 %		2,942	0.58 %
Net interest income and net interest margin (4)		$36,605	4.09 %		$32,295	4.21 %		$33,150	4.63 %

(1) Calculated on a fully tax equivalent basis, which includes Federal tax benefits relating to income earned on municipal bonds totaling $2,977, $2,322 and $1,784 in 2013, 2012 and 2011, respectively.
(2) Loan interest income includes loan fees of $320 in 2013, $646 in 2012, and $399 in 2011.
(3) Average loans do not include nonaccrual loans.
(4) Net interest margin is computed by dividing net interest income by total average interest-earning assets.

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Table B

VOLUME AND RATE ANALYSIS

The following table sets forth, for the years indicated, a summary of the changes in interest earned and interest paid resulting from changes in asset and liability volumes and changes in rates. The change in interest due to both volume and rate has been allocated to change due to volume and rate in proportion to the relationship of absolute dollar amounts of change in each.

	Years Ended December 31,					
	2013 Compared to 2012			2012 Compared to 2011		
(In thousands)	Volume	Rate	Net	Volume	Rate	Net
Increase (decrease) due to changes in:						
Interest income:						
Interest-earning deposits in other banks	$32	$24	$56	$(111)	$32	$(79)
Investment securities:						
Taxable	285	(1,199)	(914)	11,056	(12,315)	(1,259)
Non-taxable (1)	2,583	(658)	1,925	2,141	(559)	1,582
Total investment securities	2,868	(1,857)	1,011	13,197	(12,874)	323
Loans	3,012	(406)	2,606	(1,389)	(796)	(2,185)
FHLB Stock	7	134	141	2	25	27
Total earning assets (1)	5,918	(2,105)	3,813	11,699	(13,613)	(1,914)
Interest expense:						
Deposits:						
Savings, NOW and MMA	132	(306)	(174)	97	(463)	(366)
Certificates of deposit under $100,000	(75)	(172)	(247)	(92)	(130)	(222)
Certificates of deposit $100,000 and over	95	(34)	61	(89)	(355)	(444)
Total interest-bearing deposits	152	(512)	(360)	(84)	(948)	(1,032)
Other borrowed funds	(132)	(5)	(137)	(31)	4	(27)
Total interest bearing liabilities	20	(517)	(497)	(115)	(944)	(1,059)
Net interest income (1)	$5,898	$(1,588)	$4,310	$11,814	$(12,669)	$(855)

(1) Computed on a tax equivalent basis for securities exempt from federal income taxes.

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Table C

INVESTMENT PORTFOLIO

The amortized cost of investment securities at December 31, 2013, 2012, and 2011 is set forth in the following table. At December 31, 2013, we held no investment securities from any issuer which totaled over 10% of our shareholders' equity.

Available-for-Sale	Amortized Cost at December 31,		
(In thousands)	2013	2012	2011
U.S. Government agencies	$18,172	$9,443	149
Obligations of states and political subdivisions	162,018	151,312	101,030
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	254,978	206,465	204,222
Private label residential mortgage backed securities	4,344	6,258	8,408
Corporate debt securities	—	—	—
Other equity securities	7,596	7,596	7,596
Total Available-for-Sale Securities	$447,108	$381,074	$321,405

The amortized cost, maturities and weighted average yield of investment securities at December 31, 2013 are summarized in the following table.

(Dollars in thousands)	In one year or less		After one through five years		After five through ten years		After ten years		Total	
Available-for-Sale Securities	Amount	Yield(1)	Amount	Yield(1)	Amount	Yield(1)	Amount	Yield(1)	Amount	Yield(1)
Debt securities(2)										
U.S. Government agencies	$—	—	$—	—	$2,344	2.45 %	$15,828	4.07 %	$18,172	3.86 %
Obligations of states and political subdivisions	—	—	1,769	2.28 %	22,100	4.39 %	138,149	4.41 %	162,018	4.39 %
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	—	—	4,184	2.83 %	17,025	3.79 %	233,769	4.32 %	254,978	4.26 %
Private label residential mortgage backed securities	—	—	129	4.78	520	4.76 %	3,695	5.75 %	4,344	5.60 %
Other equity securities	7,596	2.34 %	—	—	—	—	—	—	7,596	2.34 %
	$7,596	2.34 %	$6,082	3.44 %	$41,989	4.04 %	$391,441	4.36 %	$447,108	4.27 %

(1) Not computed on a tax equivalent basis.

(2) Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties. Expected maturities will also differ from contractual maturities due to unscheduled principal pay downs.

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Table D

LOAN PORTFOLIO

The composition of the loan portfolio at December 31, 2013, 2012, 2011, 2010, and 2009 is summarized in the table below.

(In thousands)	2013	2012	2011	2010	2009
Commercial:					
Commercial and industrial	$87,082	$77,956	$78,089	$81,318	$93,282
Agricultural land and production	31,649	26,599	29,958	20,604	13,903
Total commercial	118,731	104,555	108,047	101,922	107,185
Real estate:					
Owner occupied	156,781	114,444	113,183	111,888	106,606
Real estate construction and other land loans	42,329	33,199	33,047	32,038	51,633
Commercial real estate	86,117	53,797	62,523	63,627	71,420
Agricultural real estate	44,164	28,400	42,596	44,397	38,759
Other real estate	4,548	8,098	7,892	8,103	4,610
Total real estate	333,939	237,938	259,241	260,053	273,028
Consumer:					
Equity loans and lines of credit	48,594	42,932	51,106	58,860	65,353
Consumer and installment	11,252	10,346	9,765	11,261	14,033
Total consumer	59,846	53,278	60,871	70,121	79,386
Deferred loan fees, net	(159)	(453)	(764)	(499)	(392)
Total gross loans	512,357	395,318	427,395	431,597	459,207
Allowance for credit losses	(9,208)	(10,133)	(11,396)	(11,014)	(10,200)
Total (1)	$503,149	$385,185	$415,999	$420,583	$449,007

	2013	2012	2011	2010	2009
(1) Includes nonaccrual loans of:	$7,586	$9,695	$14,434	$18,561	$18,959

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Table E

LOAN MATURITIES AND SENSITIVITY TO CHANGES IN INTEREST RATES

The following table presents information concerning loan maturities and sensitivity to changes in interest rates of the indicated categories of our loan portfolio, as well as loans in those categories maturing after one year that have fixed or floating interest rates at December 31, 2013.

(In thousands)	One Year or Less	After One Through Five Years	After Five Years	Total
Loan Maturities:				
Commercial and agricultural	$84,300	$26,967	$7,464	$118,731
Real estate construction and other land loans	37,595	1,670	3,064	42,329
Other real estate	22,400	34,164	235,046	291,610
Consumer and installment	15,465	13,137	31,244	59,846
	$159,760	$75,938	$276,818	$512,516
Sensitivity to Changes in Interest Rates:				
Loans with fixed interest rates	$42,516	$37,776	$32,886	$113,178
Loans with floating interest rates	117,243	37,490	244,605	399,338
	$159,759	$75,266	$277,491	$512,516

Table F

COMPOSITION OF NONACCRUAL, PAST DUE AND RESTRUCTURED LOANS

A summary of nonaccrual, restructured and past due loans at December 31, 2013, 2012, 2011, 2010, and 2009 is set forth below:

	December 31,				
(Dollars in thousands)	2013	2012	2011	2010	2009
Nonaccrual	$2,991	$450	$3,833	$7,906	$14,391
Restructured nonaccrual loans	4,595	9,245	10,601	10,655	4,568
	$7,586	$9,695	$14,434	$18,561	$18,959
Accruing loans past due 90 days or more	—	—	—	—	—
Accruing troubled debt restructurings	$5,771	$7,410	$9,210	$—	$—
Nonaccrual loans to total loans	1.48 %	2.45 %	3.38 %	4.30 %	4.13 %

Our consolidated financial statements are prepared on the accrual basis of accounting, including the recognition of interest income on loans. Interest income from nonaccrual loans is recorded only if collection of principal in full is not in doubt and when and if received.

Loans are placed on nonaccrual status and any accrued but unpaid interest income is reversed and charged against income when the payment of interest or principal is 90 days or more past due. Loans in the nonaccrual category are treated as nonaccrual loans even though we may ultimately recover all or a portion of the interest due. These loans return to accrual status when the loan becomes contractually current, future collectibility of amounts due is reasonably assured, and a minimum of six months of satisfactory principal repayment performance has occurred. As of December 31, 2013, nonaccrual loans totaled $7,586,000 and interest foregone on nonaccrual loans totaled $661,000 for the year then ended. As of December 31, 2012, we had nonaccrual loans totaling $9,695,000 and interest foregone on nonaccrual loans totaled $693,000 for the year then ended. As of December 31, 2011, we had nonaccrual loans totaling $14,434,000 and interest foregone on nonaccrual loans totaled $954,000 for the year then ended. As of December 31, 2010, we had nonaccrual loans totaling $18,561,000 and interest foregone on nonaccrual loans totaled $1,228,000 for the year then ended. We had nonaccrual loans totaling $18,959,000 at December 31, 2009 and interest foregone on nonaccrual loans totaled $852,000 for the year then ended. See Note 5 of the Company's audited Consolidated Financial Statements in Item 8 of this Annual Report.

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Included in nonaccrual loans at December 31, 2013 were ten loans totaling $4,595,000 that were considered troubled debt restructurings (TDRs). None of these TDR loans were in default at December 31, 2013. There are no outstanding commitments to lend additional funds to any of these borrowers. Included in nonaccrual loans at December 31, 2012 were seven loans that totaled $9,245,000 that were considered to be TDRs at December 31, 2012. At December 31, 2011, the Company had six loans totaling $10,601,000 that were on nonaccrual and considered TDR. The Company had 12 loans at December 31, 2010 totaling $10,655,000 that were considered to be TDRs. As of December 31, 2009, the Company had seven loans totaling $4,568,000 that were on nonaccrual and considered TDR. See Note 5 of the Company's audited Consolidated Financial Statements in Item 8 of this Annual Report concerning our recorded investment in loans for which impairment has been recognized. Impaired loans are identified from internal credit review reports, past due reports, overdraft listings, and regulatory reports of examination. Borrowers experiencing problems such as operating losses, marginal working capital, inadequate cash flow or business interruptions which jeopardize collection of the loan are also reviewed for possible impairment classification.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Loans determined to be impaired are individually evaluated for impairment. When a loan is impaired, the Company measures impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, it may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. We perform quarterly internal reviews on substandard loans. We place loans on nonaccrual status and classify them as impaired when a reasonable doubt exists as to the collectibility of interest and principal under the original contractual terms, or when loans are delinquent 90 days or more unless the loan is both well secured and in the process of collection. Management maintains certain loans that have been brought current by the borrower (less than 30 days delinquent) on nonaccrual status until such time as management has determined that the loans are likely to remain current in future periods. Foregone interest on nonaccrual loans totaled $661,000 for the year ended December 31, 2013 of which $279,000 was attributable to troubled debt restructurings. Foregone interest on nonaccrual loans was $693,000 and $954,000 for 2012 and 2011, respectively of which $669,000 and $769,000 was attributable to troubled debt restructurings, respectively.

Other than as discussed above, as of December 31, 2013, we had no loans where known information about possible credit problems of borrowers caused management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms and which may result in disclosure of such loans as impaired loans.

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Table G

SUMMARY OF LOAN LOSS EXPERIENCE

The following table summarizes loan loss experience as of and for the years ended December 31, 2013, 2012, 2011, 2010, and 2009.

(Dollars in thousands)	2013	2012	2011	2010	2009
Loans outstanding at December 31,	$512,516	$395,771	$428,159	$432,096	$459,599
Average loans outstanding during the year	$454,483	$405,040	$428,291	$455,340	$482,458
Allowance for credit losses:					
Balance at beginning of year	$10,133	$11,396	$11,014	$10,200	$7,223
Deduct loans charged-off:					
Commercial and industrial	(713)	(123)	(280)	(1,938)	(1,383)
Owner occupied	(281)	(217)	—	(218)	(1,160)
Real estate construction and other land loans	—	(319)	(286)	(823)	(569)
Commercial real estate	(4)	(1,430)	(26)	(11)	(1,588)
Other real estate	—	—	—	(453)	(2,450)
Consumer loans	(448)	(761)	(940)	(679)	(776)
Total loans charged-off	(1,446)	(2,850)	(1,532)	(4,122)	(7,926)
Add recoveries of loans previously charged off:					
Commercial and industrial	315	515	286	429	45
Owner occupied	—	45	—	258	20
Real estate construction and other land loans	16	—	52	42	55
Commercial real estate	—	—	176	—	5
Other real estate	—	—	—	81	201
Consumer loans	190	327	350	326	63
Total recoveries	521	887	864	1,136	389
Net charge-offs	(925)	(1,963)	(668)	(2,986)	(7,537)
Add provision charged to operating expense	—	700	1,050	3,800	10,514
Balance at end of year	$9,208	$10,133	$11,396	$11,014	$10,200
Allowance for credit losses as a percentage of outstanding loan balance	1.80%	2.56%	2.66%	2.55%	2.22%
Net charge-offs to average loans outstanding	(0.20)%	(0.48)%	(0.16)%	(0.66)%	(1.56)%

Managing credits identified through the risk evaluation methodology includes developing a business strategy with the customer to mitigate our losses. Our management continues to monitor these credits with a view to identifying as early as possible when, and to what extent, additional provisions may be necessary.
The allowance for credit losses is reviewed at least quarterly by the Bank's and our Board of Directors' Audit/Compliance Committee. Reserves are allocated to loan portfolio segments using percentages which are based on both historical risk elements such as delinquencies and losses and predictive risk elements such as economic, competitive and environmental factors. We have adopted the specific reserve approach to allocate reserves to each impaired asset for the purpose of estimating potential loss exposure. Although the allowance for credit losses is

allocated to various portfolio categories, it is general in nature and available for the loan portfolio in its entirety. Additions may be required based on the results of independent loan portfolio examinations, regulatory agency examinations, or our own internal review process. Additions are also required when, in management's judgment, the reserve does not properly reflect the potential loss exposure.

No provision was added to the allowance for credit losses during the year ended December 31, 2013. The amount of provision is primarily the result of our assessment of the overall adequacy of the allowance for credit losses considering a number of factors, including the increase or decrease in the volume of outstanding loans and the level of net charge offs during the year. The provision for credit losses for the year ended December 31, 2012 was $700,000. For 2011, the provision decreased to $1,050,000 which was due to a reduction in net charge offs which were $668,000 and a period-to-period decrease in the level of outstanding loans. As of December 31, 2010 the provision decreased to $3,800,000 because of the reduction in

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net charge offs which were $2,986,000 with a period-to-period decrease in the level of outstanding loans. In 2009, the Bank added $10,514,000 to the provision based on our assessment of the overall adequacy of the allowance for credit losses including the increase in the volume of outstanding loans and the level of net charge offs during the year of $7,537,000.

Using the criteria on the previous page, the allocation of the allowance for credit losses is set forth below:

	2013		2012		2011		2010		2009	
(Dollars in thousands)	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans
Commercial and industrial	$1,872	16.4 %	$1,955	18.4 %	$1,853	16.8 %	$2,149	17.4 %	$2,861	22.2 %
Real estate construction, land development and other land loans	1,289	8.3 %	1,035	8.4 %	2,954	7.7 %	1,791	7.4 %	836	10.3 %
Real estate - other	3,213	48.3 %	4,196	44.5 %	3,712	42.8 %	3,579	42.5 %	3,813	48.2 %
Equity loans and lines of credit	874	9.5 %	1,158	10.9 %	1,419	12.0 %	1,975	13.6 %	334	7.8 %
Loans to finance agricultural and other loans to farmers	1,189	14.7 %	1,251	13.9 %	831	16.9 %	674	15.1 %	708	7.8 %
Loans to individuals for household, family and other personal expenditures and other loans	295	2.2 %	383	2.6 %	417	2.3 %	528	2.6 %	423	2.4 %
Other	54	0.6 %	116	1.3 %	71	1.5 %	80	1.4 %	48	1.3 %
Unallocated reserve	422	—	39	—	139	—	238	—	1,177	—
	$9,208	100.0 %	$10,133	100.0 %	$11,396	100.0 %	$11,014	100.0 %	$10,200	100.0 %

Loans are charged to the allowance for credit losses when the loans are deemed uncollectible. It is the policy of management to make additions to the allowance so that it remains adequate to cover all probable loan charge-offs that exist in the portfolio at that time. We assign qualitative and environmental factors (Q factors) to each loan category. Q factors include reserves held for the effects of lending policies, economic trends, and portfolio trends along with other dynamics which may cause additional stress to the portfolio.

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Table H

DEPOSITS

We have no known foreign deposits. The following table sets forth the average amount of and the average rate paid on certain deposit categories which were in excess of 10% of average total deposits for the years ended December 31, 2013, 2012, and 2011.

	2013		2012		2011	
(Dollars in thousands)	Balance	Rate	Balance	Rate	Balance	Rate
NOW accounts	$163,034	0.15 %	$142,231	0.19 %	$124,899	0.26 %
Money market accounts	$193,833	0.12 %	$178,734	0.22 %	$174,049	0.40 %
Time certificates of deposit	$155,036	0.48 %	$146,133	0.64 %	$166,731	0.96 %
Non-interest bearing demand	$283,956	—	$217,529	—	$182,244	—
Total deposits	$848,493	0.15 %	$719,601	0.23 %	$677,789	0.39 %

Table I

TIME DEPOSITS

The following table sets forth the maturity of time certificates of deposit and other time deposits of $100,000 or more at December 31, 2013.

(In thousands)	
Three months or less	$39,490
Over 3 months through 6 months	28,504
Over 6 through 12 months	25,476
Over 12 months	22,546
	$116,016

Table J

FINANCIAL RATIOS

The following table sets forth certain financial ratios for the years ended December 31, 2013, 2012, and 2011.

	2013	2012	2011
Net income:			
To average assets	0.84 %	0.88 %	0.81 %
To average shareholders’ equity	6.89 %	6.56 %	6.26 %
Dividends declared per share to net income per share	26.32 %	6.33 %	—
Average shareholders’ equity to average assets	12.13 %	13.43 %	12.92 %

Supervision and Regulation

GENERAL

The banking and financial services businesses in which we engage are highly regulated. Such regulation is intended, among other things, to protect depositors whose deposits are insured by the FDIC and the banking system as a whole. The monetary and fiscal policies of the federal government and the policies of regulatory agencies, particularly the Board of Governors, also influence the commercial banking business. The Board of Governors implements national monetary policies

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(with objectives such as curbing inflation and combating recession) by its open-market operations in United States Government securities, by adjusting the required level of reserves for financial intermediaries subject to its reserve requirements and by varying the discount rates applicable to borrowings by depository institutions. The actions of the Board of Governors in these areas influence the growth of bank loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. Indirectly such actions may also affect the ability of non-bank financial institutions to compete with the Bank. The nature and impact of any future changes in monetary policies cannot be predicted.

The laws, regulations, and policies affecting financial services businesses are continuously under review by Congress and state legislatures, and federal and state regulatory agencies. From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial intermediaries. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial intermediaries are frequently made in Congress, in the California legislature and before various bank regulatory and other professional agencies. Changes in the laws, regulations or policies that affect us cannot necessarily be predicted, but they may have a material effect on our business and earnings.

BANK HOLDING COMPANY REGULATION

The Company, as a bank holding company, is subject to regulation under the BHC Act, and is subject to the supervision and examination of the Board of Governors. Pursuant to the BHC Act, we are required to obtain the prior approval of the Board of Governors before we may acquire all or substantially all of the assets of any bank, or ownership or control of voting shares of any bank if, after giving effect to such acquisition, we would own or control, directly or indirectly, more than five percent of such bank.

Under the BHC Act, we may not engage in any business other than managing or controlling banks or furnishing services to our subsidiaries that the Board of Governors deems to be so closely related to banking as to be a proper incident to banking. We are also prohibited, with certain exceptions, from acquiring direct or indirect ownership or control of more than five percent of the voting shares of any company unless the company is engaged in banking activities or the Board of Governors determines that the activity is so closely related to banking to be a proper incident to banking. The Board of Governors' approval must be obtained before the shares of any such company can be acquired and, in certain cases, before any approved company can open new offices.

The BHC Act and regulations of the Board of Governors also impose certain constraints on the redemption or purchase by a bank holding company of its own shares of stock.

Our earnings and activities are affected by legislation, by actions of regulators, and by local legislative and administrative bodies and decisions of courts in the jurisdictions in which both the Company and the Bank conduct business. For example, these include limitations on the ability of the Bank to pay dividends to the Company and the ability of the Company to pay dividends to its shareholders. It is the policy of the Board of Governors that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiaries. Various federal and state statutory provisions limit the amount of dividends that subsidiary banks can pay to their holding companies without regulatory approval. In addition to these explicit limitations, the federal regulatory agencies are authorized to prohibit a banking subsidiary or bank holding company from engaging in an unsafe or unsound banking practice. Depending upon the circumstances, the agencies could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

In addition, banking subsidiaries of bank holding companies are subject to certain restrictions imposed by federal law in dealings with their holding companies and other affiliates. Subject to certain exceptions set forth in the Federal Reserve Act and Regulation W, a bank can make a loan or extend credit to an affiliate, purchase or invest in the securities of an affiliate, purchase assets from an affiliate, accept securities of an affiliate as collateral security for a loan or extension of credit to any person or company, issue a guarantee, or accept letters of credit on behalf of an affiliate only if the aggregate amount of the above transactions of such subsidiary does not exceed 10 percent of such subsidiary's capital stock and surplus on a per affiliate basis or 20 percent of such subsidiary's capital stock and surplus on an aggregate affiliate basis. Such transactions must be on terms and conditions that are consistent with safe and sound banking practices. A bank and its subsidiaries generally may not purchase a "low-quality asset," as that term is defined in the Federal Reserve Act, from an affiliate. Such restrictions also generally prevent a holding company and its other affiliates from borrowing from a banking subsidiary of the holding company unless the loans are secured by collateral.

A holding company and its banking subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, sale or lease of property or provision of services. For example, with certain exceptions a bank may not condition an extension of credit on a customer obtaining other services provided by it, a holding company or any of its other bank affiliates, or on a promise by the customer not to obtain other services from a competitor.

The Board of Governors has cease and desist powers over parent bank holding companies and non-banking subsidiaries where actions of a parent bank holding company or its non-financial institution subsidiaries represent an unsafe or

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unsound practice or violation of law. The Board of Governors has the authority to regulate debt obligations (other than commercial paper) issued by bank holding companies by imposing interest ceilings and reserve requirements on such debt obligations.

We are also a bank holding company within the meaning of Section 3700 of the California Financial Code. As such, we and our subsidiaries are subject to examination by the Department of Business Oversight (DBO).

Further, we are required by the Board of Governors to maintain certain capital levels. See "Capital Standards."

REGULATION OF THE BANK

Banks are extensively regulated under both federal and state law. The Bank, as a California state-chartered bank, is subject to primary supervision, regulation and periodic examination by the DBO and the FDIC. The Bank is not a member of the Federal Reserve System, but is nevertheless subject to certain regulations of the Board of Governors.

If, as a result of an examination of a bank, the FDIC should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of the Bank's operations are unsatisfactory or that the Bank or its management is violating or has violated any law or regulation, various remedies are available to the FDIC. Such remedies include the power to enjoin "unsafe or unsound" practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in capital, to restrict the growth of the Bank, to assess civil monetary penalties, to remove officers and directors, and ultimately to terminate the Bank's deposit insurance, which for a California chartered bank would result in a revocation of the Bank's charter. The DBO has many of the same remedial powers.

The Bank is a member of the FDIC, which currently insures customer deposits in each member bank to a maximum of $250,000 per depositor. For this protection, the Bank is subject to the rules and regulations of the FDIC, and, as is the case with all insured banks, may be required to pay a semi-annual statutory assessment. All of a depositors' accounts at an insured depository institution, including all non-interest bearing transactions accounts, will be insured by the FDIC up to the standard maximum deposit insurance amount of ($250,000) for each deposit insurance ownership category.

Various requirements and restrictions under the laws of the State of California and the United States affect the operations of the Bank. State and federal statutes and regulations relate to many aspects of the Bank's operations, including standards for safety and soundness, reserves against deposits, interest rates payable on deposits, loans, investments, mergers and acquisitions, borrowings, dividends, locations of branch offices, fair lending requirements, Community Reinvestment Act activities, and loans to affiliates.

PAYMENT OF DIVIDENDS

THE COMPANY

Our shareholders are entitled to receive dividends when and as declared by our Board of Directors, out of funds legally available, subject to the dividends preference, if any, on preferred shares that may be outstanding, and also subject to the restrictions of the California Corporations Code. See Note 14 of the Company's audited Consolidated Financial Statements in Item 8 of this Annual Report concerning preferred stock issued through the Small Business Lending Fund of the United States Department of the Treasury on August 18, 2011 and preferred stock and common stock issued pursuant to Stock Purchase Agreements with accredited private investors.

The principal source of cash revenue to the Company is dividends received from the Bank. The Bank's ability to make dividend payments to the Company is subject to state and federal regulatory restrictions.

THE BANK

Dividends payable by 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 paid during that period, or, with the approval of the DBO, 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.

In addition to the regulations concerning minimum uniform capital adequacy requirements described below, the FDIC has established guidelines regarding the maintenance of an adequate allowance for credit losses. Therefore, the future payment of cash dividends by the Bank will generally depend, in addition to regulatory constraints, upon the Bank's earnings during any fiscal period, the assessment of the Board of Directors of the capital requirements of the Bank and other factors, including the maintenance of an adequate allowance for credit losses.

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CAPITAL STANDARDS

Banks and bank holding companies are subject to various capital requirements administered by state and federal banking agencies. Capital adequacy guidelines 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 judgments by regulators about components, risk weighting and other factors.

The Board of Governors, the FDIC and other federal banking agencies have issued risk-based capital adequacy guidelines intended to provide a measure of capital adequacy that reflects the degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets, and transactions, such as letters of credit and recourse arrangements, which are reported as off-balance-sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off-balance-sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as certain U.S. government securities, to 100% for assets with relatively higher credit risk, such as business loans.

A banking organization's risk-based capital ratios are obtained by dividing its qualifying capital by its total risk-adjusted assets and off-balance-sheet items. The regulators measure risk-adjusted assets and off-balance-sheet items against both total qualifying capital (the sum of Tier 1 capital and limited amounts of Tier 2 capital) and Tier 1 capital. Tier 1 capital consists of common stock, retained earnings, noncumulative perpetual preferred stock and minority interests in certain subsidiaries, less most other intangible assets. Tier 2 capital may consist of a limited amount of the allowance for possible loan and lease losses and certain other instruments with some characteristics of equity. The inclusion of elements of Tier 2 capital is subject to certain other requirements and limitations of the federal banking agencies. Since December 31, 1992, the federal banking agencies have required a minimum ratio of qualifying total capital to risk-adjusted assets and off-balance-sheet items of 8%, and a minimum ratio of Tier 1 capital to risk-adjusted assets and off-balance-sheet items of 4%.

In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to average total assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets is 3%. It is improbable, however, that an institution with a 3% leverage ratio would receive the highest rating by the regulators since a strong capital position is a significant part of the regulators' rating. For all banking organizations not rated in the highest category, the minimum leverage ratio is at least 100 to 200 basis points above the 3% minimum. Thus, the effective minimum leverage ratio, for all practical purposes, is at least 4% or 5%. In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the regulators have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios.

A bank that does not achieve and maintain the required capital levels may be issued a capital directive by the FDIC to ensure the maintenance of required capital levels. As discussed above, the Company and the Bank are required to maintain certain levels of capital. The regulatory capital guidelines as well as the actual capitalization for the Bank and the Company on a consolidated basis as of December 31, 2013 are as follows:

	Requirement		Actual	
	Adequately Capitalized	For the Bank to be Well Capitalized	Bank	Company
Total risk-based capital ratio	8.00 %	10.00 %	15.04 %	15.13 %
Tier 1 risk-based capital ratio	4.00 %	6.00 %	13.79 %	13.88 %
Tier 1 leverage capital ratio	4.00 %	5.00 %	8.09 %	8.14 %

In December 2010, the internal Basel Committee on Bank Supervision ("Basel Committee") released its final framework for strengthening international capital and liquidity regulation, now officially identified as "Basel III," which, when fully phased-in, would require bank holding companies and their bank subsidiaries to maintain substantially more capital than currently required, with a greater emphasis on common equity. The Basel III capital framework, among other things:

- introduces as a new capital measure, Common Equity Tier 1 ("CET1"), more commonly known in the United States as "Tier 1 Common," and defines CET1 narrowly by requiring that most adjustments to regulatory capital measures be made to CET1 and not to the other components of capital, and expands the scope of the adjustments as compared to existing regulations;
- when fully phased in, requires banks to maintain: (i) a newly adopted international standard, a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%); (ii) an additional "SIFI buffer" for those large institutions deemed to be systemically important, ranging from 1.0% to 2.5%, and up to 3.5% under certain conditions; (iii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is

phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation); (iv) a minimum ratio of Total (that is, Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation); and (v) as a newly adopted international standard, a minimum leverage ratio of 3%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (as the average for each quarter of the month-end ratios for the quarter); and

- an additional “countercyclical capital buffer,” generally to be imposed when national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk, that would be a CET1 add-on to the capital conservation buffer in the range of 0% to 2.5% when fully implemented.
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In July 2013, the U.S. banking agencies approved the U.S. version of Basel III. The federal bank regulatory agencies adopted version of Basel III revises the risk-based and leverage capital requirements and the method for calculating risk-weighted assets to make them consistent with Basel III and to meet the requirements of the Dodd-Frank Act. Although many of the rules contained in these final regulations are applicable only to large, internationally active banks, some of them will apply on a phased in basis to all banking organizations, including the Company and the Bank. Among other things, the rules establish a new minimum common equity Tier 1 ratio (4.5% of risk-weighted assets), a higher minimum Tier 1 risk-based capital requirement (6.0% of risk-weighted assets) and a minimum non-risk-based leverage ratio (4.00% eliminating a 3.00% exception for higher rated banks). The new additional capital conservation buffer of 2.5% of risk weighted assets over each of the required capital ratios will be phased in from 2016 to 2019 and must be met to avoid limitations on the ability of the Company and the Bank to pay dividends, repurchase shares or pay discretionary bonuses. The additional “countercyclical capital buffer” is also required for larger and more complex institutions. The new rules assign higher risk weighting to exposures that are more than 90 days past due or are on nonaccrual status and certain commercial real estate facilities that finance the acquisition, development or construction of real property. The rules also change the permitted composition of Tier 1 capital to exclude trust preferred securities, mortgage servicing rights and certain deferred tax assets and include unrealized gains and losses on available for sale debt and equity securities (with a one-time opt out option for Standardized Banks (banks with less than $250 billion of total consolidated assets and less than $10 billion of foreign exposures) which the Company and the Bank intend to exercise). The rules, including alternative requirements for smaller community financial institutions like the Company and the Bank, would be phased in through 2019. The implementation of the Basel III framework is to commence January 1, 2015. The Company has reviewed and will continue to evaluate the new Basel III regulatory capital requirements.

VOLCKER RULE

The final rules adopted on December 10, 2013, to implement a part of the Dodd-Frank Act commonly referred to as the “Volcker Rule”, would prohibit insured depository institutions and companies affiliated with insured depository institutions (“banking entities”) from engaging in short-term proprietary trading of certain securities, derivatives, commodity futures and options on these instruments, for their own account. The final rules also impose limits on banking entities’ investments in, and other relationships with, hedge funds or private equity funds. These rules will become effective on April 1, 2014. Certain collateralized debt obligations (“CDOs”), securities backed by trust preferred securities which were initially defined as covered funds subject to the investment prohibitions, have been exempted to address the concern that many community banks holding such CDOs securities may have been required to recognize significant losses on those securities.

Like the Dodd-Frank Act, the final rules provide exemptions for certain activities, including market making, underwriting, hedging, trading in government obligations, insurance company activities, and organizing and offering hedge funds or private equity funds. The final rules also clarify that certain activities are not prohibited, including acting as agent, broker, or custodian.

The compliance requirements under the final rules vary based on the size of the banking entity and the scope of activities conducted. Banking entities with significant trading operations will be required to establish a detailed compliance program and their CEOs will be required to attest that the program is reasonably designed to achieve compliance with the final rule. Independent testing and analysis of an institution’s compliance program will also be required. The final rules reduce the burden on smaller, less-complex institutions by limiting their compliance and reporting requirements. Additionally, a banking entity that does not engage in covered trading activities will not need to establish a compliance program. The Company and the Bank held no investment positions at December 31, 2013 that were subject to the final rule. Therefore, while these new rules may require us to conduct certain internal analysis and reporting, we believe that they will not require any material changes in our operations or business.

USA PATRIOT ACT

On October 26, 2001, President Bush signed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001. The USA PATRIOT Act also made significant changes to the Bank Secrecy Act. Under the USA PATRIOT Act, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and of identifying customers when

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establishing new relationships and standards in their dealings with foreign financial institutions and foreign customers. For example, the enhanced due diligence policies, procedures, and controls generally require financial institutions to take reasonable steps:
* To conduct enhanced scrutiny of account relationships to guard against money laundering and report any suspicious transaction;
* To ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, each account as needed to guard against money laundering and report any suspicious transactions;
* To ascertain for any foreign bank, the shares of which are not publicly traded, the identity of the owners of the foreign bank, and the nature and extent of the ownership interest of each such owner; and
* To ascertain whether any foreign bank provides correspondent accounts to other foreign banks and, if so, the identity of those foreign banks and related due diligence information.

Under the USA PATRIOT Act, financial institutions are to establish anti-money laundering programs to enhance their Bank Secrecy Act program. The USA PATRIOT Act sets forth minimum standards for these programs, including:
* The development of internal policies, procedures, and controls;
* The designation of a compliance officer;
* An ongoing employee training program; and
* An independent audit function to test the programs.

Bank management believes that the Bank is currently in compliance with the US PATRIOT Act.

FINANCIAL SERVICES MODERNIZATION LEGISLATION

On November 12, 1999, President Clinton signed into law the Gramm-Leach-Bliley Act, also known as the Financial Services Modernization Act. This legislation eliminated many of the barriers that have separated the insurance, securities and banking industries since the Great Depression. The federal banking agencies (the Board of Governors, FDIC and the Office of the Comptroller of the Currency) among others, continue to draft regulations to implement the Gramm-Leach-Bliley Act. The Gramm-Leach-Bliley Act is the result of a decade of debate in the Congress regarding a fundamental reformation of the nation’s financial system. The law is subdivided into seven titles, by functional area. The major provisions of the Gramm-Leach-Bliley Act are:

FINANCIAL HOLDING COMPANIES AND FINANCIAL ACTIVITIES. Title I establishes a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms, and other financial service providers by revising and expanding the BHC Act framework to permit a holding company system to engage in a full range of financial activities through qualification as a new entity known as a financial holding company.

Final regulations adopted by the FDIC in January 2001, in the form of amendments to Part 362 of the FDIC rules and regulations, provide the framework for subsidiaries of state nonmember banks to engage in financial activities that the Gramm-Leach-Bliley Act permits national banks to conduct through a financial subsidiary.

Activities permissible for financial subsidiaries of national banks, and, pursuant to Section 362 of the FDIC rules and regulations, also permissible for financial subsidiaries of state nonmember banks, include, but are not limited to, the following: (a) Lending, exchanging, transferring, investing for others, or safeguarding money or securities;
(b) Insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of the foregoing, in any State; (c) Providing financial, investment, or economic advisory services, including advising an investment company; (d) Issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly; and (e) Underwriting, dealing in, or making a market in securities.

SECURITIES ACTIVITIES. Title II narrows the exemptions from the securities laws previously enjoyed by banks and creates a new, voluntary investment bank holding company. The Board of Governors and the SEC continue to work together to draft rules governing certain securities activities of banks.

INSURANCE ACTIVITIES. Title III restates the proposition that the states are the functional regulators for all insurance activities, including the insurance activities of federally-chartered banks, and bars the states from prohibiting insurance activities by depository institutions.

PRIVACY. Under Title V, federal banking regulators were required to adopt rules that have limited the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. Federal banking regulators issued final rules on May 10, 2000 to implement the privacy provisions of Title V. Under the rules, financial institutions must provide:

* initial notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal information to nonaffiliated third parties and affiliates;
* annual notices of their privacy policies to current customers; and
* a reasonable method for customers to “opt out” of disclosures to nonaffiliated third parties.

Compliance with these rules was mandatory after July 1, 2001. The Company and the Bank were in full compliance with the rules as of or prior to their respective effective dates.

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SAFEGUARDING CONFIDENTIAL CUSTOMER INFORMATION. Under Title V, federal banking regulators are required to adopt rules requiring financial institutions to implement a program to protect confidential customer information. In January 2000, the federal banking agencies adopted guidelines requiring financial institutions to establish an information security program.

The Bank implemented a security program appropriate to its size and complexity and the nature and scope of its operations prior to the July 1, 2001 effective date of the regulatory guidelines, and since initial implementation has, as necessary, updated and improved that program.

COMMUNITY REINVESTMENT ACT SUNSHINE REQUIREMENTS. The federal banking agencies have adopted final regulations implementing Section 711 of Title VII of the Gramm-Leach-Bliley Act, the Sunshine Requirements. The regulations require nongovernmental entities or persons and insured depository institutions and affiliates that are parties to written agreements made in connection with the fulfillment of the institution's CRA obligations to make available to the public and the federal banking agencies a copy of each agreement. Neither the Company nor the Bank is a party to any agreement that would be the subject of reporting pursuant to the CRA Sunshine Requirements.

The Company continues to evaluate the strategic opportunities presented by the broad powers granted to bank holding companies that elect to be treated as financial holding companies. In the event that the Company determines that access to the broader powers of a financial holding company is in the best interests of the Company, its shareholders and the Bank, the Company will file the appropriate election with the Board of Governors.

The Company and the Bank intend to comply with all provisions of the Gramm-Leach-Bliley Act and all implementing regulations as they become effective.

CONSUMER PROTECTION LAWS AND REGULATIONS

The bank regulatory agencies are focusing greater attention on compliance with consumer protection laws and their implementing regulations. Examination and enforcement have become more intense in nature, and insured institutions have been advised to monitor carefully compliance with such laws and regulations. The Dodd-Frank Act transferred rulemaking authority for many consumer protection laws from various Federal agencies to the Consumer Financial Protection Bureau (CFPB). The Bank is subject to many federal consumer protection statutes and regulations, some of which are discussed below.

The Community Reinvestment Act (CRA) is intended to encourage insured depository institutions, while operating safely and soundly, to help meet the credit needs of their communities. The CRA specifically directs the federal regulatory agencies, in examining insured depository institutions, to assess a bank's record of helping meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. The CRA further requires the agencies to take a financial institution's record of meeting its community credit needs into account when evaluating applications for, among other things, domestic branches, mergers or acquisitions, or holding company formations. The agencies use the CRA assessment factors in order to provide a rating to the financial institution. The ratings range from a high of "outstanding" to a low of "substantial noncompliance." The Bank was last examined for CRA compliance by its primary regulator, the FDIC, as of February 2013.

The Equal Credit Opportunity Act (ECOA) generally prohibits discrimination in any credit transaction, whether for consumer or business purposes, on the basis of race, color, religion, national origin, sex, marital status, age, receipt of income from public assistance programs, or good faith exercise of any rights under the Consumer Credit Protection Act.

The Truth in Lending Act (TILA) is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably. As a result of the TILA, all creditors must use the same credit terminology to express rates and payments, including the annual percentage rate, the finance charge, the amount financed, the total of payments and the payment schedule, among other things.

The Fair Housing Act (FH Act) regulates many practices, including making it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status. A number of lending practices have been found by the courts to be, or may be considered, illegal under the FH Act, including some that are not specifically mentioned in the FH Act itself.

The Home Mortgage Disclosure Act (HMDA) grew out of public concern over credit shortages in certain urban neighborhoods and provides public information that will help show whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. The HMDA also includes a "fair lending" aspect that requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes.

Finally, the Real Estate Settlement Procedures Act (RESPA) requires lenders to provide borrowers with disclosures regarding the nature and cost of real estate settlements. Also, RESPA prohibits certain abusive practices, such as kickbacks, and places limitations on the amount of escrow accounts. Penalties under the above laws may include fines, reimbursements and other civil money penalties.

Due to heightened regulatory concern related to compliance with the CRA, TILA, FH Act, ECOA, HMDA and RESPA generally, the Bank may incur additional compliance costs or be required to expend additional funds for investments in its local community.

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CALIFORNIA FINANCIAL INFORMATION PRIVACY ACT/FAIR CREDIT REPORTING ACT

In 1970, the Federal Fair Credit Reporting Act (the FCRA) was enacted to insure the confidentiality, accuracy, relevancy and proper utilization of consumer credit report information. Under the framework of the FCRA, the United States has developed a highly advanced and efficient credit reporting system. The information contained in that broad system is used by financial institutions, retailers and other creditors of every size in making a wide variety of decisions regarding financial transactions. Employers and law enforcement agencies have also made wide use of the information collected and maintained in databases made possible by the FCRA. The FCRA affirmatively preempts state law in a number of areas, including the ability of entities affiliated by common ownership to share and exchange information freely, and the requirements on credit bureaus to reinvestigate the contents of reports in response to consumer complaints, among others.

The California Financial Information Privacy Act, which was enacted in 2003, requires a financial institution to provide specific information to a consumer related to the sharing of that consumer’s nonpublic personal information. The Act allows a consumer to direct the financial institution not to share his or her nonpublic personal information with affiliated or nonaffiliated companies with which a financial institution has contracted to provide financial products and services, and requires that permission from each such consumer be acquired by a financial institution prior to sharing such information.

The FACT Act, (Fair and Accurate Credit Transaction Act) became law in 2003, effectively extending and amending provisions of the Fair Credit Reporting Act (FCRA). The FACT Act created many new responsibilities for consumer reporting agencies and users of consumer reports. It contains many new consumer disclosure requirements as well as provisions to address identity theft.

CHECK 21 ACT

On December 22, 2003, the Board of Governors amended Regulation CC and its commentary to implement the Check Clearing for the 21st Century Act (Check 21 Act). The Check 21 Act became effective on October 28, 2004.

To facilitate check truncation and electronic check exchange, the Check 21 Act authorizes a new negotiable instrument called a “substitute check” and provides that a properly prepared substitute check is the legal equivalent of the original check for all purposes. A substitute check is a paper reproduction of the original check that can be processed just like the original check. The Check 21 Act does not require any bank to create substitute checks or to accept checks electronically. The amendments: 1) set forth the requirements of the Check 21 Act that applies to banks; 2) provide a model disclosure and model notices relating to substitute checks; and 3) set forth bank endorsement and identification requirements for substitute checks.

The Bank has been imaging its customers’ checks since 2000. Check 21 Act has had limited impact on the Bank.

Recent Accounting Pronouncements

Impact of New Financial Accounting Standards

Presentation of Comprehensive Income

In February 2013, the FASB issued ASU 2013-02, Comprehensive Income (“Topic 220”) - Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (“ASU 13-02”). This ASU requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under GAAP that provide additional detail about those amounts. ASU 13-02 is effective prospectively for annual and interim periods beginning after December 15, 2012. The Company adopted this standard on January 1, 2013. The adoption of this ASU did not have a material impact on the Company's financial position, results of operations, or cash flows.

Other

Other legislation which has been or may be proposed to the United States Congress and the California Legislature and regulations which may be proposed by the Board of Governors, FDIC and the DBO may affect our business. It cannot be predicted whether any pending or proposed legislation or regulations will be adopted or the effect such legislation or regulations may have upon our business.

ITEM 1A - RISK FACTORS

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An investment in our common stock is subject to risks inherent to our business. The material risks and uncertainties that Management believes may affect our business are described below. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included or incorporated by reference in this Annual Report. The risks and uncertainties described below are not the only ones facing our business. Additional risks and uncertainties that Management is not aware of or focused on or that Management currently deems immaterial may also impair our business operations. This Annual Report is qualified in its entirety by these risk factors.

If any of the following risks actually occur, our financial condition and results of operations could be materially and adversely affected. If this were to happen, the value of our common stock could decline significantly, and you could lose all or part of your investment.

Worsening economic conditions could adversely affect our business.

The economic conditions in the United States in general and within California and in our operating markets may remain weak or deteriorate. Unemployment nationwide and in California has increased significantly through this economic downturn and is anticipated to remain elevated for the foreseeable future. Availability of credit and consumer spending, real estate values, and consumer confidence have all declined markedly. The volatility of the capital markets and the credit, capital and liquidity problems confronting the U.S. financial system have not been resolved despite massive government expenditures and legislative efforts to stabilize the U.S. financial system. There is no assurance that such conditions will improve or be resolved in the foreseeable future.

The Bank conducts banking operations principally in California's Central Valley. As a result, our financial condition, results of operations and cash flows are subject to changes in the economic conditions in California's Central Valley. Our business results are dependent in large part upon the business activity, population, income levels, deposits and real estate activity in the Central Valley, and continued adverse economic conditions could have a material adverse effect upon us. In addition, the Central Valley remains largely dependent on agriculture. A downturn in agriculture and agricultural related business could indirectly and adversely affect our results of operations and financial condition. During early 2014, California experienced a severe drought. If the drought significantly harms the business of our customers, the credit quality of the loans to those customers could decline as a specific consequence of the drought. We can provide no assurance that economic conditions in the United States in general and in the State of California and within our operating markets will not further deteriorate or that such deterioration will not materially and adversely affect us. A further deterioration in economic conditions locally, regionally or nationally could result in a further economic downturn in the Central Valley with the following consequences, any of which could further adversely affect our business:

- loan delinquencies and defaults may increase;
- problem assets and foreclosures may increase;
- demand for our products and services may decline;
- low cost or noninterest bearing deposits may decrease;
- collateral for loans may decline in value, in turn reducing customers' borrowing power, and reducing the value of assets and collateral as sources of repayment of existing loans;
- foreclosed assets may not be able to be sold;
- volatile securities market conditions could adversely affect valuations of investment portfolio assets; and
- reputational risk may increase due to public sentiment regarding the banking industry.

Non-performing assets take significant time to resolve and adversely affect our results of operations and financial condition.

At December 31, 2013, our non-performing loans and leases were 1.48% of total loans and leases compared to 2.45% at December 31, 2012, and 3.38% at December 31, 2011, and our non-performing assets (which include foreclosed real estate) were 0.68% of total assets compared to 1.09% at December 31, 2012. The allowance for loan and lease losses as a percentage of non-performing loans and leases was 121.38% as of December 31, 2013 compared to

104.52% at December 31, 2012. Non-performing assets adversely affect our net income in various ways. We generally do not record interest income on non-performing loans or other real estate owned, thereby adversely affecting our income and increasing our loan administration costs. When we take collateral in foreclosures and similar proceedings, we are required to mark the related asset to the then fair market value of the collateral, which may ultimately result in a loss. An increase in the level of non-performing assets increases our risk profile and may impact the capital levels our regulators believe are appropriate in light of the ensuing risk profile, which could result in a request to reduce our level of non-performing assets. When we reduce problem assets through loan sales, workouts, restructurings and otherwise, decreases in the value of the underlying collateral, or in these borrowers' performance or financial condition, whether or not due to economic and market conditions beyond our control, could adversely affect our business, results of operations and financial condition. In addition, the resolution of non-performing assets requires significant commitments of time from management and our directors, which can be detrimental to the performance of their

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other responsibilities. There can be no assurance that we will not experience future increases in non-performing assets or that the disposition of such non-performing assets will not adversely affect our profitability.

Tightening of credit markets and liquidity risk could adversely affect our business, financial condition and results of operations.

A tightening of the credit markets or any inability to obtain adequate funds for continued loan growth at an acceptable cost could adversely affect our asset growth and liquidity position and, therefore, our earnings capability. In addition to core deposit growth, maturity of investment securities and loan and lease payments, we also rely on alternative funding sources including unsecured borrowing lines with correspondent banks, secured borrowing lines with the Federal Home Loan Bank of San Francisco and the Federal Reserve Bank of San Francisco, and public time certificates of deposits. Our ability to access these sources could be impaired by deterioration in our financial condition as well as factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations for the financial services industry or serious dislocation in the general credit markets. In the event such a disruption should occur, our ability to access these sources could be adversely affected, both as to price and availability, which would limit, or potentially raise the cost of, the funds available to us.

We have a concentration risk in real estate related loans.

At December 31, 2013, $383 million, or 74.70% of our total loan and lease portfolio, consisted of real estate related loans. Substantially all of our real property collateral is located in our operating markets in the Central Valley in California. The continuing trend of deteriorating economic conditions in California and in our operating markets has contributed to an overall decline in commercial and residential real estate values. A continuing substantial decline in commercial and residential real estate values in our primary market areas could occur as a result of worsening economic conditions or other events including natural disasters such as earthquakes, fires, and floods. Such a decline in values could have an adverse impact on us by limiting repayment of defaulted loans through sale of commercial and residential real estate collateral and by a likely increase in the number of defaulted loans to the extent that the financial condition of our borrowers is adversely affected by such a decline in values. The adverse effects of the foregoing matters upon our real estate portfolio could necessitate a material increase in the provision for loan and lease losses.

If our allowance for credit losses is not sufficient to cover actual loan losses, our earnings could decrease.

Our loan customers may not repay their loans according to the terms of these loans, and the collateral securing the payment of these loans may be insufficient to assure repayment. We may experience significant credit losses that could have a material adverse effect on our operating results. We make various assumptions and judgments about the collectibility of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the size of the allowance, we rely on our experience and our evaluation of economic conditions. If our assumptions prove to be incorrect, our current allowance may not be sufficient to cover future loan losses and adjustments may be necessary to allow for different economic conditions or adverse developments in our loan portfolio. Significant additions to our allowance would materially decrease our net income.

In addition, federal and state regulators periodically review our allowance for credit losses and may require us to increase our provision for credit losses or recognize further loan charge-offs, based on judgments different than those we make. Any increase in our allowance or charge-offs as required by these regulatory agencies could have a negative effect on us.

Our focus on lending to small to mid-sized community-based businesses may increase our credit risk.

Commercial real estate and commercial business loans generally are considered riskier than single-family residential loans because they have larger balances to a single borrower or group of related borrowers. Commercial real estate and commercial business loans involve risks because the borrowers' ability to repay the loans typically depends primarily on the successful operation of the businesses or the properties securing the loans. Most of the Bank's commercial real estate and commercial business loans are made to small to medium sized businesses who may have a heightened vulnerability to economic conditions. Moreover, a portion of these loans have been made by us in recent years and the borrowers may not have experienced a complete business or economic cycle. Furthermore, the deterioration of our borrowers' businesses may hinder their ability to repay their loans with us, which could adversely affect our results of operations.

Fluctuations in interest rates could reduce our profitability.

We realize income primarily from the difference between interest earned on loans and securities and the interest paid on deposits and borrowings. We expect that we will periodically experience "gaps" in the interest rate sensitivities of our assets and liabilities, meaning that either our interest-bearing liabilities will be more sensitive to changes in market interest rates than our interest-earning assets, or vice versa. In either event, if market interest rates should move contrary to our position, this "gap" will work against us, and our earnings may be negatively affected.

We are unable to predict fluctuations of market interest rates, which are affected by the following factors:

- inflation;
- recession;

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- a rise in unemployment;
- tightening money supply;
- international disorder; and
- instability in domestic and foreign financial markets.

Our asset/liability management strategy, which is designed to address the risk from changes in market interest rates and the shape of the yield curve, may not prevent changes in interest rates from having a material adverse effect on our results of operations and financial condition. In recent years, we have shifted our mix of assets from consisting primarily of loans to a current mix that is approximately half loans and half securities. The value of these securities is subject to interest rate risk, which we must monitor and manage successfully in order to prevent declines in value of these assets if interest rates rise in the future.

Governmental monetary policies and intervention to stabilize the U.S. financial system may affect our business and are beyond our control.

The business of banking is affected significantly by the fiscal and monetary policies of the Federal government and its agencies. Such policies are beyond our control. We are particularly affected by the policies established by the Federal Reserve Board in relation to the supply of money and credit in the United States. The instruments of monetary policy available to the Federal Reserve Board can be used in varying degrees and combinations to directly affect the availability of bank loans and deposits, as well as the interest rates charged on loans and paid on deposits, and this can and does have a material effect on our business.

Legislation including the Emergency Economic Stabilization Act of 2008 (the EESA), signed into law by President Bush on October 3, 2008, and the American Recovery and Reinvestment Act of 2009 (the ARRA), signed into law by President Obama on February 17, 2009, each include programs that are intended to help stabilize the U.S. financial system. However, it is uncertain whether such legislation will sufficiently resolve the volatility of capital and credit markets or improve capital and liquidity problems confronting the financial system. The failure of the EESA or ARRA to mitigate or eliminate such volatility and problems affecting the financial markets and a continuation or worsening of current financial market conditions could limit our access to capital or sources of liquidity in amounts and at times necessary to conduct operations in compliance with applicable regulatory requirements.

Competition with other financial institutions could adversely affect our profitability.

We face vigorous competition from banks and other financial institutions, including savings institutions, finance companies and credit unions. A number of these banks and other financial institutions have substantially greater resources and lending limits, larger branch systems and a wider array of banking services. To a limited extent, we also compete with other providers of financial services, such as money market mutual funds, brokerage firms, consumer finance companies and insurance companies. This competition may reduce or limit our margins on banking services, reduce our market share and adversely affect our results of operations and financial condition. Additionally, we face competition primarily from other banks in attracting, developing and retaining qualified banking professionals.

Technology implementation problems or computer system failures could adversely affect us.

Our future growth prospects will be highly dependent on our ability to implement changes in technology that affect the delivery of banking services such as the increased demand for computer access to bank accounts and the availability to perform banking transactions electronically. Our ability to compete will depend upon our ability to continue to adapt technology on a timely and cost-effective basis to meet such demands. In addition, our business and operations could be susceptible to adverse effects from computer failures, communication and energy disruption, and activities such as fraud of unethical individuals with the technological ability to cause disruptions or failures of our data processing system.

Information security breaches or other technological difficulties could adversely affect us.

We cannot be certain that the continued implementation of safeguards will eliminate the risk of vulnerability to technological difficulties or failures or ensure the absence of a breach of information security. We will continue to rely on the services of various vendors who provide data processing and communication services to the banking industry. Nonetheless, if information security is compromised or other technology difficulties or failures occur at the Bank or with one of our vendors, information may be lost or misappropriated, services and operations may be interrupted and the Bank could be exposed to claims from its customers as a result.

Our controls over financial reporting and related governance procedures may fail or be circumvented.
Management regularly reviews and updates our internal control over financial reporting, disclosure controls and procedures, and corporate governance policies and procedures. We maintain controls and procedures to mitigate risks such as processing system failures or errors and customer or employee fraud, and we maintain insurance coverage for certain of these risks. Any system of controls and procedures, however well designed and operated, is based in part on certain assumptions and provides only reasonable, not absolute, assurances that the objectives of the system are met. Events could occur which are not

prevented or detected by our internal controls, are not insured against, or are in excess of our insurance limits. Any failure or circumvention of our controls and procedures, or failure to comply with regulations related to controls and procedures, could have an adverse effect on our business.

We may not be successful in raising additional capital needed in the future.
If additional capital is needed in the future as a result of losses, our business strategy or regulatory requirements, there is no assurance that our efforts to raise such additional capital will be successful or that shares sold in the future will be sold at prices or on terms equal to or better than the current market price. The inability to raise additional capital when needed or at prices and terms acceptable to us could adversely affect our ability to implement our business strategies.

The effects of legislation in response to current credit conditions may adversely affect us.
Legislation that has or may be passed at the Federal level and/or by the State of California in response to current conditions affecting credit markets could cause us to experience higher credit losses if such legislation reduces the amount that the Bank's borrowers are otherwise contractually required to pay under existing loan contracts. Such legislation could also result in the imposition of limitations upon the Bank's ability to foreclose on property or other collateral or make foreclosure less economically feasible. Such events could result in increased loan and lease losses and require a material increase in the allowance for loan and lease losses.

The effects of changes to FDIC insurance coverage limits are uncertain and increased premiums may adversely affect us.
The Bank's deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to applicable legal limits. All of a depositors' accounts at an insured depository institution, including all non-interest bearing transactions accounts, will be insured by the FDIC up to the standard maximum deposit insurance amount of ($250,000) for each deposit insurance ownership category.
Increases in FDIC insurance premiums will add to our cost of operations and could have a significant impact on the Bank. Depending on any future losses that the FDIC insurance fund may suffer due to failed institutions, there can be no assurance that there will not be additional significant premium increases in order to replenish the fund.
On February 7, 2011, the FDIC Board of Directors adopted the final rule, which redefined the deposit insurance assessment base as required by the Consumer Protection Act (Dodd-Frank), and makes changes to assessment rates, implements Dodd-Frank's Deposit Insurance Fund (DIF) dividend provisions, and revises the risk based assessment system for all large institutions. The final rule redefined the deposit insurance assessment base as average consolidated total assets minus average tangible equity, defined as Tier 1 capital. The final rule adopted a new assessment rate schedule effective April 1, 2011, and in lieu of dividends, other rate schedules when the reserve ratio reaches certain levels and was paid at the end of September 2011. The rule lowers overall assessment rates in order to generate the same approximate amount of revenue under the new larger base as was raised under the old base. The assessment rate in total is between 2.5 and 9 basis points on the broader base for banks in the lowest risk category, and 30 to 45 basis points for banks in the highest risk category.

In the future we may be required to recognize impairment with respect to investment securities, including the FHLB stock we hold.
Our securities portfolio contains whole loan private mortgage-backed securities and currently includes securities with unrecognized losses and securities that have been downgraded to below investment grade by national rating agencies. We may continue to observe declines in the fair market value of these securities. We evaluate the securities portfolio for any other-than-temporary impairment each reporting period, as required by generally accepted accounting principles, and for the year ended December 31, 2013, we recorded $17,000 in other-than-temporary impairment. There can be no assurance, however, that future evaluations of the securities portfolio will not require us to recognize further impairment charges with respect to these and other holdings.

In addition, as a condition to membership in the Federal Home Loan Bank of San Francisco (the FHLB), we are required to purchase and hold a certain amount of FHLB stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB. At December 31, 2013, we held stock in the FHLB totaling $4,499,000. The FHLB stock held by us is carried at cost and is subject to recoverability testing under applicable accounting standards. To date, the FHLB has not discontinued the distribution of dividends on its shares. However, there can be no assurance the FHLB's dividend paying practices will continue. As of December 31, 2013, we did not recognize an impairment charge related to our FHLB stock holdings. There can be no assurance, however, that future negative changes to the financial condition of the FHLB may not require us to recognize an impairment charge with respect to such holdings.

If the goodwill we have recorded in connection with our acquisitions becomes impaired, it could have an adverse impact on our earnings and capital.

At December 31, 2013, we had approximately $29,917,000 of goodwill on our balance sheet attributable to our acquisitions of the Bank of Madera County in January 2005, Service 1st Bancorp in November 2008, and Visalia Community

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Bank in July 2013. In accordance with generally accepted accounting principles, our goodwill is not amortized but rather evaluated for impairment on an annual basis or more frequently if events or circumstances indicate that a potential impairment exists. Such evaluation is based on a variety of factors, including the quoted price of our common stock, market prices of the common stock of other banking organizations, common stock trading multiples, discounted cash flows, and data from comparable acquisitions. There can be no assurance that future evaluations of goodwill will not result in findings of impairment and write-downs, which could be material.

We may raise additional capital, which could have a dilutive effect on the existing holders of our common stock and adversely affect the market price of our common stock.

We are not restricted from issuing additional shares of common stock or securities that are convertible into or exchangeable for, or that represent the right to receive, common stock. We frequently evaluate opportunities to access the capital markets taking into account our regulatory capital ratios, financial condition and other relevant considerations, and subject to market conditions, we may take further capital actions. Such actions could include, among other things, the issuance of additional shares of common stock in public or private transactions in order to further increase our capital levels above the requirements for a well-capitalized institution established by the Federal bank regulatory agencies as well as other regulatory targets.

The issuance of any additional shares of common stock or securities convertible into or exchangeable for common stock or that represent the right to receive common stock, or the exercise of such securities including, without limitation, securities issued upon exercise of outstanding stock options under our stock option plans, could be substantially dilutive to shareholders of our common stock. With the exception of one major shareholder, holders of our shares of common stock have no preemptive rights that entitle holders to purchase their pro rata share of any offering of shares of any class or series and, therefore, such sales or offerings could result in increased dilution to our shareholders. The market price of our common stock could decline as a result of sales of shares of our common stock or the perception that such sales could occur.

The price of our common stock may fluctuate significantly, and this may make it difficult for you to resell shares of common stock owned by you at times or at prices you find attractive.

The stock market and, in particular, the market for financial institution stocks, has experienced significant volatility, which, in recent quarters, has reached unprecedented levels. In some cases, the markets have produced downward pressure on stock prices for certain issuers without regard to those issuers' underlying financial strength. As a result, the trading volume in our common stock may fluctuate more than usual and cause significant price variations to occur. This may make it difficult for you to resell shares of common stock owned by you at times or at prices you find attractive. The low trading volume in our common shares on the NASDAQ Capital Market means that our shares may have less liquidity than other publicly traded companies. We cannot ensure that the volume of trading in our common shares will be maintained or will increase in the future.

The trading price of the shares of our common stock will depend on many factors, which may change from time to time and which may be beyond our control, including, without limitation, our financial condition, performance, creditworthiness and prospects, future sales or offerings of our equity or equity related securities, and other factors identified above in the forward-looking statement discussion under the section titled "Cautionary Statements Regarding Forward-Looking Statements" and below. These broad market fluctuations have adversely affected and may continue to adversely affect the market price of our common stock. Among the factors that could affect our stock price are:

- actual or anticipated quarterly fluctuations in our operating results and financial condition;
- changes in financial estimates or publication of research reports and recommendations by financial analysts or actions taken by rating agencies with respect to our common stock or those of other financial institutions;
- failure to meet analysts' revenue or earnings estimates;
- speculation in the press or investment community generally or relating to our reputation, our market area, our competitors or the financial services industry in general;
- strategic actions by us or our competitors, such as acquisitions, restructurings, dispositions or financings;

- actions by our current shareholders, including sales of common stock by existing shareholders and/or directors and executive officers;
- fluctuations in the stock price and operating results of our competitors;
- future sales of our equity, equity-related or debt securities;
- changes in the frequency or amount of dividends or share repurchases;
- proposed or adopted regulatory changes or developments;
- anticipated or pending investigations, proceedings, or litigation that involves or affects us;
- trading activities in our common stock, including short-selling;
- domestic and international economic factors unrelated to our performance; and

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- general market conditions and, in particular, developments related to market conditions for the financial services industry.

A significant decline in our stock price could result in substantial losses for individual shareholders.

We may not be able to maintain our historical growth rate which may adversely impact our results of operations and financial condition.

We have initiated internal asset growth programs, completed various acquisitions and opened additional offices in the past few years. We may not be able to sustain our historical rate of asset growth or may not even be able to grow at all. We may not be able to obtain the financing necessary to fund additional asset growth and may not be able to find suitable candidates for acquisition. Various factors, such as economic conditions and competition, may impede or prohibit the opening of new branch offices. Further, our inability to attract and retain experienced bankers may adversely affect our internal asset growth. A significant decrease in our historical rate of asset growth may adversely impact our results of operations and financial condition.

We may be unable to complete future acquisitions, and once complete, may not be able to integrate our acquisitions successfully.

Our growth strategy includes our desire to acquire other financial institutions. We may not be able to complete any future acquisitions and, for completed acquisitions, we may not be able to successfully integrate the operations, management, products and services of the entities we acquire. We may not realize expected cost savings or make revenue enhancements. Following each acquisition, we must expend substantial managerial, operating, financial and other resources to integrate these entities. In particular, we may be required to install and standardize adequate operational and control systems, deploy or modify equipment, implement marketing efforts in new as well as existing locations and employ and maintain qualified personnel. Our failure to successfully integrate the entities we acquire into our existing operations may adversely affect our financial condition and results of operations.

We operate in a highly regulated environment and may be adversely affected by changes in federal and local laws and regulations.

We are subject to extensive regulation, supervision and examination by federal and state banking authorities. Any change in applicable regulations or federal or state legislation could have a substantial impact on us and our operations. Additional legislation and regulations may be enacted or adopted in the future that could significantly affect our powers, authority and operations, which could have a material adverse effect on our financial condition and results of operations. Further, regulators have significant discretion and power to prevent or remedy unsafe or unsound practices or violations of laws by banks and bank holding companies in the performance of their supervisory and enforcement duties. The exercise of this regulatory discretion and power may have a negative impact on us.

We are experiencing an influx of locally based competition that could affect near term results.

Recently, several new banks have opened in our service areas. We are seeing price competition from these new banks, as they work to establish their markets. The existence of competitors, large and small, is a normal and expected part of our operations, but in responding to the particular short-term impact on business of new entrants to the marketplace, we could see a negative impact on revenue and income. Moreover, these near term impacts could be accentuated by the seasonal impact on revenue and income generated by the borrowing and deposit habits of the agricultural community that comprises a significant component of our customer base.

ITEM 2 - DESCRIPTION OF PROPERTY.

The Company owns the property on which the Main Office, a full-service branch office, is located in Clovis, California. In addition, the Company owns the property on which the Foothill Office, a full-service branch office, is located in Prather, California, the property on which the Modesto office, a full-service branch office, is located in

Modesto, California, the property on which the Kerman Office, a full-service branch office, is located in Kerman, California, the property on which the Floral office, a full-service branch office, is located in Visalia, California, and the property on which the Exeter office, a full service branch office, is located in Exeter, California.

All other property is leased by the Company, including the principal executive offices in Fresno. This facility houses the Company's corporate offices, comprised of various departments, including accounting, information services, human resources, real estate department, loan servicing, credit administration, branch support operations, and compliance.

The Company continually evaluates the suitability and adequacy of the Company's offices and has a program of relocating or remodeling them as necessary to be efficient and attractive facilities. Management believes that its existing facilities are adequate for its present purposes.

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Properties owned by the Bank are held without loans or encumbrances. All of the property leased is leased directly from independent parties. Management considers the terms and conditions of each of the existing leases to be in the aggregate favorable to the Company. See Note 13 of the Company's audited Consolidated Financial Statements in Item 8 of this Annual Report.

ITEM 3 - LEGAL PROCEEDINGS.

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 consolidated results of operations of the Company.
None of our directors, officers, affiliates, more than 5% shareholder or any associates of these persons is a party adverse to the Company or the Bank or has a material interest adverse to the Company or the Bank in any material legal proceeding.

ITEM 4 - MINE SAFETY DISCLOSURES

None to report.

PART II

ITEM 5 - MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Our common stock is listed for trading on the Nasdaq Capital Market under the ticker symbol CVCY. As of December 31, 2013, we had approximately 888 shareholders of record.

The following table shows the high and low sales prices for the common stock for each quarter as reported by NASDAQ.

Common Stock Prices

	Quarter 1 2012	Quarter 2 2012	Quarter 3 2012	Quarter 4 2012	Quarter 1 2013	Quarter 2 2013	Quarter 3 2013	Quarter 4 2013
High	$7.25	$7.75	$8.50	$9.25	9.00	10.14	10.50	12.82
Low	$5.25	$6.77	$6.90	$7.74	7.69	8.00	9.09	9.50

We paid $0.20 per common share cash dividends in 2013. We paid $0.05 per common share cash dividends in 2012. The Company's primary source of income with which to pay cash dividends are dividends from the Bank. The Bank would not pay any dividend that would cause it to be deemed not "well capitalized" under applicable banking laws and regulations. See Note 14 in the audited Consolidated Financial Statements in Item 8 of this Annual Report.

ISSUER PURCHASES OF EQUITY SECURITIES

Not Applicable

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EQUITY COMPENSATION PLAN INFORMATION

The following chart sets forth information for the year ended December 31, 2013, regarding equity based compensation plans of the Company.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	380,430	$8.83	296,540
Equity compensation plans not approved by security holders	N/A	N/A	N/A
Total	380,430	$8.83	296,540

No options to purchase shares of the Company's common stock were issued during the year ending December 31, 2013 from any of the Company's stock based compensation plans. In 2012, options to purchase 92,150 shares of common stock were granted from the 2005 Plan at exercise prices between $8.02 and $8.75.

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ITEM 6 - SELECTED CONSOLIDATED FINANCIAL DATA

	Years Ended December 31,				
(In thousands, except per share amounts)	2013	2012	2011	2010	2009
Statements of Income					
Total interest income	$34,836	$31,820	$34,299	$36,013	36,013
Total interest expense	1,385	1,883	2,942	4,283	6,627
Net interest income before provision for credit losses	33,451	29,937	31,357	31,730	34,107
Provision for credit losses	—	700	1,050	3,800	10,514
Net interest income after provision for credit losses	33,451	29,237	30,307	27,930	23,593
Non-interest income	7,832	7,242	6,271	3,711	5,850
Non-interest expenses	31,686	27,274	28,240	28,731	27,531
Income before provision for (benefit from) income taxes	9,597	9,205	8,338	2,910	1,912
Provision for (benefit from) income taxes	1,347	1,685	1,861	(369)	(676)
Net income	8,250	7,520	6,477	3,279	2,588
Preferred stock dividends and accretion of discount	350	350	486	395	365
Net income available to common shareholders	$7,900	$7,170	$5,991	$2,884	$2,223
Basic earnings per share	$0.77	$0.75	$0.63	$0.31	$0.29
Diluted earnings per share	$0.77	$0.75	$0.63	$0.31	$0.28
Cash dividends declared per common share	$0.20	$0.05	$—	$—	$—

	December 31,				
(In thousands)	2013	2012	2011	2010	2009
Balances at end of year:					
Investment securities, Federal funds sold and deposits in other banks	$529,398	$424,516	$353,808	$280,967	$232,142
Net loans	503,149	385,185	415,999	420,583	449,007
Total deposits	1,004,143	751,432	712,986	650,495	640,167
Total assets	1,145,635	890,228	849,023	777,594	765,488
Shareholders’ equity	120,043	117,665	107,482	97,391	91,223
Earning assets	1,042,552	801,098	762,654	695,410	677,955
Average balances:					
Investment securities, Federal funds sold and deposits in other banks	$445,859	$368,818	$299,935	$231,761	$199,425
Net loans	444,770	394,675	417,273	444,418	473,850
Total deposits	848,493	719,601	677,789	636,166	632,263
Total assets	986,924	853,078	800,178	758,852	752,509
Shareholders’ equity	119,746	114,561	103,386	96,174	83,400
Earning assets	895,330	766,937	715,862	672,804	671,906

Data from 2013 reflects the partial year impact of the acquisition of Visalia Community Bank on July 1, 2013.

ITEM 7 - MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Management’s discussion and analysis should be read in conjunction with the Company’s audited Consolidated Financial Statements, including the Notes thereto, in Item 8 of this Annual Report.

Certain matters discussed in this report constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements contained herein that are not historical facts, such as statements regarding the Company’s current business strategy and the Company’s plans for future development and operations, are based upon current expectations. These statements are forward-looking in nature and involve a number of risks and uncertainties. Such risks and uncertainties include, but are not limited to (1) significant increases in competitive pressure in the banking industry; (2) the impact of changes in interest rates, a decline in economic conditions at the international, national or local level on the Company’s results of operations, the Company’s ability to continue its internal growth at historical rates, the Company’s ability to maintain its net interest margin, and the quality of the Company’s earning assets; (3) changes in the regulatory environment; (4) fluctuations in the real estate market; (5) changes in business conditions and inflation; (6) changes in securities markets (7) risks associated with acquisitions, relating to difficulty in integrating combined operations and related negative impact on earnings, and incurrence of substantial expenses. Therefore, the information set forth in such forward-looking statements should be carefully considered when evaluating the business prospects of the Company.

When the Company uses in this Annual Report the words “anticipate,” “estimate,” “expect,” “project,” “intend,” “commit,” “b and similar expressions, the Company intends to identify forward-looking statements. Such statements are not guarantees of performance and are subject to certain risks, uncertainties and assumptions, including those described in this Annual Report. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, expected, projected, intended, committed or believed. The future results and shareholder values of the Company may differ materially from those expressed in these forward-looking statements. Many of the factors that will determine these results and values are beyond the Company’s ability to control or predict. For those statements, the Company claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. See also the discussion of risk factors in Item 1A, “Risk Factors.”

INTRODUCTION

Central Valley Community Bancorp (NASDAQ: CVCY) (the Company) was incorporated on February 7, 2000. The formation of the holding company offered the Company more flexibility in meeting the long-term needs of customers, shareholders, and the communities it serves. The Company currently has one bank subsidiary, Central Valley Community Bank (the Bank) and one business trust subsidiary, Service 1st Capital Trust 1. The Bank of Madera County (BMC) was merged with and into the Bank on January 1, 2005. BMC had two branches in Madera County which continue to be operated by the Bank. After the close of business on November 12, 2008, Service 1st Bancorp (Service 1st) was merged with and into the Company, and Service 1st Bank was merged with and into the Bank. Service 1st Bank had three branches in Stockton, Tracy, and Lodi which continue to be operated by the Bank. Service 1st Capital Trust 1 (the Trust) is a business trust formed for the purpose of issuing trust preferred securities. The Company succeeded to all the rights and obligations of Service 1st in connection with the acquisition of Service 1st. The Trust is a subsidiary of the Company. Effective July 1, 2013, the Company and Visalia Community Bank (VCB) completed a merger under which Visalia Community Bank, with three full-service offices in Visalia and one in Exeter, merged with and into the Bank. The Company’s market area includes the central valley area from Sacramento, California to Bakersfield, California.

During 2013, we focused on asset quality and capital adequacy due to the uncertainty created by the economy. We also focused on assuring that competitive products and services were made available to our clients while adjusting to the many new laws and regulations that affect the banking industry.

The Bank now operates 21 full-service offices. The Bank has a Real Estate Division, an Agribusiness Center and an SBA Lending Division in Fresno. All real estate related transactions are conducted and processed through the Real Estate Division, including interim construction loans for single family residences and commercial buildings. We offer permanent single family residential loans through our mortgage broker services.

ECONOMIC CONDITIONS

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The economy in California's Central Valley has been negatively impacted by the recession that began in 2007 and the related real estate market and the slowdown in residential construction. The recession has impacted most industries in our market area. Since 2007, housing values throughout the nation and especially in the Central Valley have decreased dramatically, which in turn has negatively affected the personal net worth of much of the population in our service area. Housing in the Central Valley continues to be relatively more affordable than the major metropolitan areas in California.

Agriculture and agricultural related businesses remain a critical part of the Central Valley's economy. The Valley's agricultural production is widely diversified, producing nuts, vegetables, fruit, cattle, dairy products, and cotton. The continued future success of agriculture related businesses is highly dependent on the availability of water and is subject to fluctuation in worldwide commodity prices and demand. During early 2014, California experienced a severe drought. If the drought significantly harms the business of our customers, the credit quality of the loans to those customers could decline as a specific consequence of the drought.

OVERVIEW

Diluted earnings per share (EPS) for the year ended December 31, 2013 was $0.77 compared to $0.75 and $0.63 for the years ended December 31, 2012 and 2011, respectively. Net income for 2013 was $8,250,000 compared to $7,520,000 and $6,477,000 for the years ended December 31, 2013, 2012, and 2011, respectively. The increase in net income and EPS was primarily driven by increases in net interest income, lower provision for credit losses, increase in non-interest income, partially offset by increases in non-interest expense in 2013 compared to 2012. Total assets at December 31, 2013 were $1,145,635,000 compared to $890,228,000 at December 31, 2012.

Return on average equity for 2013 was 6.89% compared to 6.56% and 6.26% for 2012 and 2011, respectively. Return on average assets for 2013 was 0.84% compared to 0.88% and 0.81% for 2012 and 2011, respectively. Total equity was $120,043,000 at December 31, 2013 compared to $117,665,000 at December 31, 2012. The increase in assets and equity in 2013 compared to 2012 is primarily related to the VCB acquisition on July 1, 2013, and also due to increases in deposits and retained earnings offset by a decrease in other comprehensive income.

Average total loans increased $49,443,000 or 12.21% to $454,483,000 in 2013 compared to $405,040,000 in 2012. In 2013, we recorded no provision for credit losses compared to $700,000 in 2012 and $1,050,000 in 2011. The Company had nonperforming assets totaling $7,776,000 at December 31, 2013. Nonperforming assets included nonaccrual loans totaling $7,586,000 and Other Real Estate Owned (OREO) totaling $190,000. At December 31, 2012, nonperforming assets totaled $9,695,000 consisting of $9,695,000 in nonaccrual loans. Net charge-offs for 2013 were $925,000 compared to $1,963,000 for 2012 and $668,000 for 2011. Refer to "Asset Quality" below for further information.

Key Factors in Evaluating Financial Condition and Operating Performance

As a publicly traded community bank holding company, we focus on several key factors including:

- Return to our shareholders;
- Return on average assets;
- Development of revenue streams, including net interest income and non-interest income;
- Asset quality;
- Asset growth;
- Capital adequacy;
- Operating efficiency; and
- Liquidity.

Return to Our Shareholders

One measure of our return to our shareholders is the return on average equity (ROE). Our ROE was 6.89% for the year ended 2013 compared to 6.56% and 6.26% for the years ended 2012 and 2011, respectively. In 2013, compared to 2012 we experienced both an increase in net income and an increase in capital due to increases in retained earnings, offset by a decrease in other comprehensive income.

Our net income for the year ended December 31, 2013 increased $730,000 compared to 2012 and increased $1,043,000 for 2012 compared to 2011. During 2013, net income increased due to increases in net interest income, increases in non-interest income, a decrease in the provision for credit losses and a decrease in tax expense, partially offset by increases in non-interest expenses in 2013 compared to 2012. Net interest income increased because of increases in loan and investment income, partially offset by decreases in interest expense on deposits. Net interest income during 2013 was positively impacted by the collection in full of a non-accrual loan of $4,731,000 which resulted in a recovery of foregone interest of $1,484,000. Non-interest income increased primarily driven by a $382,000 increase in service charge income, a $195,000 increase in interchange fees, a $141,000 increase in Federal Home Loan Bank dividends, and an increase in loan placement fees of

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$46,000, partially offset by a $374,000 decrease in net realized gains on sales and calls of investment securities and a decrease of $12,000 in gains on the sale of other real estate owned.
Non-interest expenses increased in 2013 compared to 2012 primarily due to increases in acquisition and integration-related expenses of $692,000, salary and employee benefit expenses of $1,830,000, occupancy and equipment expenses of $531,000, consulting expenses of $299,000, data processing expenses of $258,000, amortization of core deposit intangibles of $68,000, and regulatory assessments of $44,000, partially offset by decreases in legal fees of $69,000, and advertising fees of $82,000. During 2013, our net interest margin (NIM) decreased 12 basis points compared to 2012. Basic EPS was $0.77 for 2013 compared to $0.75 and $0.63 for 2012 and 2011, respectively. Diluted EPS was $0.77 for 2013 compared to $0.75 and $0.63 for 2012 and 2011, respectively. The increase in EPS in 2013 was due primarily to the increase in net income.

Return on Average Assets

Our return on average assets (ROA) is a ratio that measures our performance compared with other banks and bank holding companies. Our ROA for the year ended 2013 was 0.84% compared to 0.88% and 0.81% for the years ended December 31, 2012 and 2011, respectively. The 2013 decrease in ROA is primarily due to the increase in average assets as a result of the VCB acquisition. Annualized ROA for our peer group was 0.86% at September 30, 2013. Peer group information from SNL Financial data includes bank holding companies in central California with assets from $300 million to $1.2 billion that are not subchapter S corporations.

Development of Revenue Streams

Over the past several years, we have focused on not only our net income, but improving the consistency of our revenue streams in order to create more predictable future earnings and reduce the effect of changes in our operating environment on our net income. We minimized the effects of the recent interest rate decline on our net interest margin by focusing on core deposits and managing the cost of funds. Our net interest margin (fully tax equivalent basis) was 4.09% for the year ended December 31, 2013, compared to 4.21% and 4.63% for the years ended December 31, 2012 and 2011, respectively. The decrease in net interest margin compared to 2012 is principally due to a decrease in our yield on earning assets which was greater than the decrease in our cost of funds. In comparing the two periods, the effective yield on total earning assets decreased 22 basis points, while the cost of total interest-bearing liabilities decreased 13 basis points and the cost of total deposits decreased 8 basis points. Our cost of total deposits in 2013 was 0.15% compared to 0.23% for the same period in 2012 and 0.39% for the year ended December 31, 2011. Our net interest income before provision for credit losses increased $3,514,000 or 11.74% to $33,451,000 for the year ended 2013 compared to $29,937,000 and $31,357,000 for the years ended 2012 and 2011, respectively.
Our non-interest income is generally made up of service charges and fees on deposit accounts, fee income from loan placements, appreciation in cash surrender value of bank owned life insurance, and net gains from sales and calls of investment securities. Non-interest income in 2013 increased $590,000 or 8.15% to $7,832,000 compared to $7,242,000 in 2012 and $6,271,000 in 2011. The increase resulted primarily from increases in service charge income, interchange fees, and loan placement fees compared to the comparable 2012 period, partially offset by a decreases in net realized gains on sales and calls of investment securities and gain on sale of other real estate owned. Customer service charges increased $382,000 or 13.77% to $3,156,000 in 2013 compared to $2,774,000 and $2,903,000 in 2012 and 2011, respectively. Further detail on non-interest income is provided below.

Asset Quality

For all banks and bank holding companies, asset quality has a significant impact on the overall financial condition and results of operations. Asset quality is measured in terms of percentage of total loans and total assets, and is a key element in estimating the future earnings of a company. Total nonperforming assets were $7,776,000 and $9,695,000 at December 31, 2013 and 2012, respectively. Nonperforming assets totaled 1.52% of gross loans as of December 31, 2013 and 2.45% of gross loans as of December 31, 2012. The Company had $190,000 in other real estate owned (OREO) at December 31, 2013 as compared to none at December 31, 2012. The OREO property held at December 31, 2013 was sold for book value during January 2014. Management maintains certain loans that have been brought current by the borrower (less than 30 days delinquent) on nonaccrual status until such time as management has determined that the loans are likely to remain current in future periods.

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Asset Growth

As revenues from both net interest income and non-interest income are a function of asset size, the continued growth in assets has a direct impact in increasing net income and therefore ROE and ROA. The majority of our assets are loans and investment securities, and the majority of our liabilities are deposits, and therefore the ability to generate deposits as a funding source for loans and investments is fundamental to our asset growth. Total assets increased 28.69% during 2013 to $1,145,635,000 as of December 31, 2013 from $890,228,000 as of December 31, 2012. Total gross loans increased 29.61% to $512,357,000 as of December 31, 2013, compared to $395,318,000 at December 31, 2012. Total investment securities and Federal funds sold increased 12.44% to $443,442,000 as of December 31, 2013 compared to $394,393,000 as of December 31, 2012. Total deposits increased 33.63% to $1,004,143,000 as of December 31, 2013 compared to $751,432,000 as of December 31, 2012. The asset growth in 2013 was largely due to the VCB Acquisition. Our loan to deposit ratio at December 31, 2013 was 51.02% compared to 52.61% at December 31, 2012. The loan to deposit ratio of our peers was 70.41% at September 30, 2013.

Capital Adequacy

At December 31, 2013, we had a total capital to risk-weighted assets ratio of 15.13%, a Tier 1 risk-based capital ratio of 13.88% and a leverage ratio of 8.14%. At December 31, 2012, we had a total capital to risk-weighted assets ratio of 19.53%, a Tier 1 risk-based capital ratio of 18.24% and a leverage ratio of 10.56%. At December 31, 2013, on a stand-alone basis, the Bank had a total risk-based capital ratio of 15.04%, a Tier 1 risk based capital ratio of 13.79% and a leverage ratio of 8.09%. At December 31, 2012, the Bank had a total risk-based capital ratio of 18.96%, Tier 1 risk-based capital of 17.67% and a leverage ratio of 10.22%. The deterioration in 2013 is due to an increase in risk weighted assets while risk adjusted capital decreased primarily due to the redemption of Series C Preferred Stock. Note 14 of the audited Consolidated Financial Statements provides more detailed information concerning the Company's capital amounts and ratios.

Operating Efficiency

Operating efficiency is the measure of how efficiently earnings before taxes are generated as a percentage of revenue. A lower ratio represents greater efficiency. The Company's efficiency ratio (operating expenses, excluding amortization of intangibles and foreclosed property expense, divided by net interest income plus non-interest income, excluding net gains and losses from sale of securities) was 78.50% for 2013 compared to 75.99% for 2012 and 75.68% for 2011. The increase in the efficiency ratio in 2013 is due to an increase in net interest income that is less than the increase in operating expenses. The decline in the efficiency ratio in 2012 compared to 2011 is due to a decrease in net interest income that is greater than the decrease in operating expenses. The Company's net interest income before provision for credit losses plus non-interest income increased 11.04% to $41,283,000 in 2013 compared to $37,179,000 in 2012 and $37,628,000 in 2011, while operating expenses increased 16.18% in 2013, decreased 3.42% in 2012, and decreased 1.71% in 2011.

Liquidity

Liquidity management involves our ability to meet cash flow requirements arising from fluctuations in deposit levels and demands of daily operations, which include providing for customers' credit needs, funding of securities purchases, and ongoing repayment of borrowings. Our liquidity is actively managed on a daily basis and reviewed periodically by our management and Directors' Asset/Liability Committee. This process is intended to ensure the maintenance of sufficient funds to meet our needs, including adequate cash flows for off-balance sheet commitments. Our primary sources of liquidity are derived from financing activities which include the acceptance of customer and, to a lesser extent, broker deposits, Federal funds facilities and advances from the Federal Home Loan Bank of San Francisco. We have available unsecured lines of credit with correspondent banks totaling approximately $40,000,000 and

secured borrowing lines of approximately $272,797,000 with the Federal Home Loan Bank. These funding sources are augmented by collection of principal and interest on loans, the routine maturities and pay downs of securities from our investment securities portfolio, the stability of our core deposits, and the ability to sell investment securities. Primary uses of funds include origination and purchases of loans, withdrawals of and interest payments on deposits, purchases of investment securities, and payment of operating expenses.
We had liquid assets (cash and due from banks, interest-earning deposits in other banks, Federal funds sold and available-for-sale securities) totaling $555,276,000 or 48.47% of total assets at December 31, 2013 and $446,921,000 or 50.20% of total assets as of December 31, 2012.

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RESULTS OF OPERATIONS

Net Income

Net income was $8,250,000 in 2013 compared to $7,520,000 and $6,477,000 in 2012 and 2011, respectively. Basic earnings per share was $0.77, $0.75, and $0.63 for 2013, 2012, and 2011, respectively. Diluted earnings per share was $0.77, $0.75, and $0.63 for 2013, 2012, and 2011, respectively. ROE was 6.89% for 2013 compared to 6.56% for 2012 and 6.26% for 2011. ROA for 2013 was 0.84% compared to 0.88% for 2012 and 0.81% for 2011.
The increase in net income for 2013 compared to 2012 can be attributed to a decrease in the provision for credit losses, an increase in interest income, an increase in non interest income, and a decrease in provision for income taxes, partially offset by an increase in non-interest expense. The increase in net income for 2012 compared to 2011 can be attributed to the decrease in the provision for credit losses, an increase in non-interest income, and a decrease in provision for income taxes, partially offset by decrease in interest income.

Interest Income and Expense

Net interest income is the most significant component of our income from operations. Net interest income (the interest rate spread) is the difference between the gross interest and fees earned on the loan and investment portfolios and the interest paid on deposits and other borrowings. Net interest income depends on the volume of and interest rate earned on interest-earning assets and the volume of and interest rate paid on interest-bearing liabilities.

The following table sets forth a summary of average balances with corresponding interest income and interest expense as well as average yield and cost information for the periods presented. Average balances are derived from daily balances, and nonaccrual loans are not included as interest-earning assets for purposes of this table.

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SCHEDULE OF AVERAGE BALANCES, AVERAGE YIELDS AND RATES

	Year Ended December 31, 2013			Year Ended December 31, 2012			Year Ended December 31, 2011		
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Average Interest Rate	Average Balance	Interest Income/ Expense	Average Interest Rate	Average Balance	Interest Income/ Expense	Average Interest Rate
ASSETS									
Interest-earning deposits in other banks	$46,672	$164	0.35 %	$36,836	$108	0.29 %	$73,016	$187	0.26 %
Securities									
Taxable securities	235,487	2,375	1.01 %	218,325	3,289	1.51 %	150,559	4,548	3.02 %
Non-taxable securities (1)	163,494	8,755	5.35 %	113,039	6,830	6.04 %	75,665	5,248	6.94 %
Total investment securities	398,981	11,130	2.79 %	331,364	10,119	3.05 %	226,224	9,796	4.33 %
Federal funds sold	206	1	0.25 %	618	2	0.30 %	695	2	0.29 %
Total securities and interest-earning deposits	445,859	11,295	2.53 %	368,818	10,229	2.77 %	299,935	9,985	3.33 %
Loans (2) (3)	445,300	26,519	5.96 %	394,575	23,913	6.06 %	412,969	26,098	6.32 %
Federal Home Loan Bank stock	4,171	177	4.24 %	3,544	36	1.02 %	2,958	9	0.30 %
Total interest-earning assets	895,330	$37,991	4.24 %	766,937	$34,178	4.46 %	715,862	$36,092	5.04 %
Allowance for credit losses	(9,713)			(10,365)			(11,018)		
Nonaccrual loans	9,183			10,465			15,322		
Other real estate owned	50			919			217		
Cash and due from banks	21,296			19,525			17,977		
Bank premises and equipment	7,816			6,217			5,788		
Other non-earning assets	62,962			59,380			56,030		
Total average assets	$986,924			$853,078			$800,178		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Interest-bearing liabilities:									
Savings and NOW accounts	$215,668	$291	0.13 %	$177,205	$302	0.17 %	$154,765	$368	0.24 %
Money market accounts	193,833	229	0.12 %	178,734	392	0.22 %	174,049	692	0.40 %
Time certificates of deposit, under $100,000	48,729	219	0.45 %	59,838	466	0.78 %	70,111	688	0.98 %
Time certificates of deposit, $100,000 and	106,307	531	0.50 %	86,295	470	0.54 %	96,620	914	0.95 %

over												
Total interest-bearing deposits	564,537	1,270	0.22	%	502,072	1,630	0.32	%	495,545	2,662	0.54	%
Other borrowed funds	5,645	116	2.05	%	9,156	253	2.76	%	10,265	280	2.73	%
Total interest-bearing liabilities	570,182	$1,386	0.24	%	511,228	$1,883	0.37	%	505,810	$2,942	0.58	%
Non-interest bearing demand deposits	283,956				217,529				182,244			
Other liabilities	13,040				9,760				8,738			
Shareholders' equity	119,746				114,561				103,386			
Total average liabilities and shareholders' equity	$986,924				$853,078				$800,178			
Interest income and rate earned on average earning assets		$37,991	4.24	%		$34,178	4.46	%		$36,092	5.04	%
Interest expense and interest cost related to average interest-bearing liabilities		1,386	0.24	%		1,883	0.37	%		2,942	0.58	%
Net interest income and net interest margin (4)		$36,605	4.09	%		$32,295	4.21	%		$33,150	4.63	%

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(1) Calculated on a fully tax equivalent basis, which includes Federal tax benefits relating to income earned on municipal bonds totaling $2,977, $2,322, and $1,784 in 2013, 2012, and 2011, respectively.
(2) Loan interest income includes loan fees of $320 in 2013, $646 in 2012, and $399 in 2011.
(3) Average loans do not include nonaccrual loans.
(4) Net interest margin is computed by dividing net interest income by total average interest-earning assets.

Interest and fee income from loans increased $2,606,000 or 10.90% in 2013 compared to 2012. Interest and fee income decreased $2,185,000 or 8.37% in 2012 compared to 2011. The increase in 2013 is attributable to a increase in average total loans outstanding offset by a 10 basis point decrease in the yield on loans. Net interest income during 2013 was positively impacted by VCB acquisition in addition to the collection in full of a non-accrual loan of $4,731,000 which resulted in a recovery of foregone interest of $1,484,000. The decrease in 2012 is attributable to a decrease in average total loans outstanding and a 26 basis point decrease in yield on loans compared to 2011. Average total loans for 2013 increased $49,443,000 to $454,483,000 compared to $405,040,000 for 2012 and $428,291,000 for 2011. The yield on loans for 2013 was 5.96% compared to 6.06% and 6.32% for 2012 and 2011, respectively.
Interest income from total investments on a non tax-equivalent basis, (total investments include investment securities, Federal funds sold, interest-bearing deposits in other banks, and other securities), increased $410,000 or 5.19% in 2013 compared to 2012. The yield on average investments decreased 24 basis points to 2.53% for the year ended December 31, 2013 from 2.77% for the year ended December 31, 2012. The increase of the investment portfolio balance at significantly reduced yields contributed to the decreases in net interest income and net interest margin. Average total investments increased $77,041,000 to $445,859,000 in 2013 compared to $368,818,000 in 2012. In 2012, total investment income decreased $294,000 or 3.58% compared to 2011. The increase of the investment portfolio balance at significantly reduced yields contributed to the decreases in net interest income and net interest margin.
A significant portion of the investment portfolio is mortgage-backed securities (MBS) and collateralized mortgage obligations (CMOs). At December 31, 2013, we held $259,100,000 or 58.46% of the total market value of the investment portfolio in MBS and CMOs with an average yield of 0.94%. We invest in Collateralized Mortgage Obligations (CMO) and Mortgage Backed Securities, (MBS) as part of the overall strategy to increase our net interest margin. CMOs and MBS by their nature react to changes in interest rates. In a normal declining rate environment, prepayments from MBS and CMOs would be expected to increase and the expected life of the investment would be expected to shorten. Conversely, if interest rates increase, prepayments normally would be expected to decline and the average life of the MBS and CMOs would be expected to extend. However, in the current economic environment, prepayments may not behave according to historical norms. Premium amortization and discount accretion of these investments affects our net interest income. Our management monitors the prepayment speed of these investments and adjusts premium amortization and discount accretion based on several factors. These factors include the type of investment, the investment structure, interest rates, interest rates on new mortgage loans, expectation of interest rate changes, current economic conditions, the level of principal remaining on the bond, the bond coupon rate, the bond origination date, and volume of available bonds in market. The calculation of premium amortization and discount accretion is by nature inexact, and represents management’s best estimate of principal pay downs inherent in the total investment portfolio.
The net of tax effect value of the change in market value of the available-for-sale investment portfolio was a loss of $2,286,000 and is reflected in the Company’s equity. At December 31, 2013, the average life of the investment portfolio was 5.62 years and the market value reflected a pre-tax loss of $3,884,000. Management reviews market value declines on individual investment securities to determine whether they represent other-than-temporary impairment (OTTI). For the years ended December 31, 2013 and 2011, OTTI was recorded in the amount of $17,000 and $31,000, respectively. No OTTI was recorded in 2012. Future deterioration in the market values of our investment securities may require the Company to recognize additional OTTI losses.
A component of the Company’s strategic plan has been to use its investment portfolio to offset, in part, its interest rate risk relating to variable rate loans. Measured at December 31, 2013, an immediate rate increase of 200 basis points

would result in an estimated decrease in the market value of the investment portfolio by approximately $40,981,000. Conversely, with an immediate rate decrease of 200 basis points, the estimated increase in the market value of the investment portfolio would be $32,152,000. The modeling environment assumes management would take no action during an immediate shock of 200 basis points. However, the Company uses those increments to measure its interest rate risk in accordance with regulatory requirements and to measure the possible future risk in the investment portfolio. For further discussion of the Company's market risk, refer to Quantitative and Qualitative Disclosures about Market Risk.

Management's review of all investments before purchase includes an analysis of how the security will perform under several interest rate scenarios to monitor whether investments are consistent with our investment policy. The policy addresses issues of average life, duration, and concentration guidelines, prohibited investments, impairment, and prohibited practices.

Total interest income in 2013 increased $3,016,000 to $34,836,000 compared to $31,820,000 in 2012 and $34,299,000 in 2011. The increase was the result of collection of $1,484,000 of foregone interest, asset mix changes, and an increase in average earning assets, partially offset by an increase in interest-bearing liabilities. The yield on interest earning assets decreased to 4.24% for the year ended December 31, 2013 from 4.46% for the year ended December 31, 2012. Average interest earning assets increased to $895,330,000 for the year ended December 31, 2013 compared to $766,937,000 for the year ended December 31, 2012. Average interest-earning deposits in other banks increased $9,836,000 comparing 2013 to 2012. Average yield on these deposits was 0.35%. Average investments increased $77,041,000 but the tax equivalent yield on average investment securities decreased 24 basis points. Average total loans increased $49,443,000 and the yield on average loans decreased 10 basis points.

The decrease in total interest income in 2012 was due to the 58 basis point decrease in the tax equivalent yield on average interest earning asset and a change in the mix of interest earning assets. The yield on interest-earning assets decreased to 4.46% for the year ended December 31, 2012 from 5.04% for the year ended December 31, 2011. Average interest-earning assets increased to 766,937,000 for the year ended December 31, 2012 compared to $715,862,000 for the year ended December 31, 2011.

Interest expense on deposits in 2013 decreased $360,000 or 22.09% to $1,270,000 compared to $1,630,000 in 2012 and $2,662,000 in 2011. The decrease in interest expense in 2013 compared to 2012 was primarily due to the repricing of interest-bearing deposits which decreased 10 basis points to 0.22% in 2013 from 0.32% in 2012. The decrease in interest expense in 2012 compared to 2011 was due to repricing of interest-bearing deposits, which decreased 22 basis points to 0.32% in 2012 from 0.54% in 2011. Average interest-bearing deposits were $564,537,000 for 2013 compared to $502,072,000 and $495,545,000 for 2012 and 2011, respectively. The increases in average interest-bearing deposits in 2013 was the result of the Visalia Community Bank acquisition and our own organic growth.

Average other borrowings decreased to $5,645,000 with an effective rate of 2.05% for 2013 compared to $9,156,000 with an effective rate of 2.76% for 2012. In 2011, the average other borrowings were $10,265,000 with an effective rate of 2.73%. Included in other borrowings are the junior subordinated deferrable interest debentures acquired from Service 1st, advances on lines of credit and advances from the Federal Home Loan Bank (FHLB). The FHLB advances are fixed rate short-term and long-term borrowings. Advances were utilized as part of a leveraged strategy in the first quarter of 2008 to purchase investment securities. The effective rate of the FHLB advances was 3.64 for 2013, and 3.59% 2012, and 2011.

The cost of all of our interest-bearing liabilities decreased 13 basis points to 0.24% for 2013 compared to 0.37% for 2012 and 0.58% for 2011. The cost of total deposits decreased to 0.15% for the year ended December 31, 2013 compared to 0.23% and 0.39% for the years ended December 31, 2012 and 2011, respectively. Average demand deposits increased 30.54% to $283,956,000 in 2013 compared to $217,529,000 for 2012 and $182,244,000 for 2011. The ratio of non-interest demand deposits to total deposits increased to 33.47% for 2013 compared to 30.23% and 26.89% for 2012 and 2011, respectively.

Net Interest Income before Provision for Credit Losses

Net interest income before provision for credit losses for 2013 increased $3,514,000 or 11.74% to $33,451,000 compared to $29,937,000 for 2012 and $31,357,000 for 2011. The increase in 2013 was due to the increase in average earning assets and 9 basis point decrease in the average interest rate on deposits, partially offset by the decrease in the average rate on earning assets. Our net interest margin (NIM) decreased 12 basis point. Yield on interest earning assets decreased 22 basis points while the effective rate on interest bearing liabilities only decreased 13 basis points. The change in the mix of average interest earning assets also affected NIM. Interest-earning deposits in other banks and investment securities, which tend to have lower effective yields, increased. Net interest income before provision for credit losses decreased $1,420,000 in 2012 compared to 2011 mainly due to the 42 basis point decrease in our net interest margin (NIM). Average interest-earning assets were $895,330,000 for the year ended December 31, 2013 with a net interest margin (NIM) of 4.09% compared to $766,937,000 with a NIM of 4.21% in 2012, and $715,862,000 with a NIM of 4.63% in 2011. For a discussion of the repricing of our assets and liabilities, refer to Quantitative and Qualitative Disclosure about Market Risk.

Provision for Credit Losses

We provide for probable credit losses by a charge to operating income based upon the composition of the loan portfolio, delinquency levels, losses and nonperforming assets, economic and environmental conditions and other factors which, in management's judgment, deserve recognition in estimating credit losses. Loans are charged off when they are considered uncollectible or of such little value that continuance as an active earning bank asset is not warranted.

The establishment of an adequate credit allowance is based on both an accurate risk rating system and loan portfolio management tools. The Board has established initial responsibility for the accuracy of credit risk grades with the individual credit officer. The grading is then submitted to the Chief Credit Administrator (CCA), who reviews the grades for accuracy and gives final approval. The CCA is not involved in loan originations. The risk grading and reserve allocation is analyzed quarterly by the CCA and the Board and at least annually by a third party credit reviewer and by various regulatory agencies.

Quarterly, the CCA sets the specific reserve for all adversely risk-graded credits. This process includes the utilization of loan delinquency reports, classified asset reports, and portfolio concentration reports to assist in accurately assessing credit

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risk and establishing appropriate reserves. Reserves are also allocated to credits that are not impaired based on inherent risk in those loans.

The allowance for credit losses is reviewed at least quarterly by the Board's Audit/Compliance Committee and by the Board of Directors. Reserves are allocated to loan portfolio categories using percentages which are based on both historical risk elements such as delinquencies and losses and predictive risk elements such as economic, competitive and environmental factors. We have adopted the specific reserve approach to allocate reserves to each impaired asset for the purpose of estimating potential loss exposure. Although the allowance for credit losses is allocated to various portfolio categories, it is general in nature and available for the loan portfolio in its entirety. Additions may be required based on the results of independent loan portfolio examinations, regulatory agency examinations, or our own internal review process. Additions are also required when, in management's judgment, the allowance does not properly reflect the portfolio's probable loss exposure.

The allocation of the allowance for credit losses is set forth below:

Loan Type (Dollars in thousands)	December 31, 2013	% of Total Loans		December 31, 2012	% of Total Loans	
Commercial:						
Commercial and industrial	$1,928	17.0	%	$2,071	19.7	%
Agricultural land and production	516	6.1	%	605	6.7	%
Real estate:						
Owner occupied	1,697	30.6	%	2,153	28.9	%
Real estate construction and other land loans	1,289	8.3	%	1,035	8.4	%
Commercial real estate	1,406	16.8	%	1,886	13.6	%
Agricultural real estate	672	8.6	%	646	7.2	%
Other real estate	110	0.9	%	157	2.0	%
Total real estate	5,174	65.2	%	5,877	60.1	%
Consumer:						
Equity loans and lines of credit	874	9.5	%	1,158	10.9	%
Consumer and installment	294	2.2	%	383	2.6	%
Unallocated reserves	422			39		
Total allowance for credit losses	$9,208			$10,133		

Loans are charged to the allowance for credit losses when the loans are deemed uncollectible. It is the policy of management to make additions to the allowance so that it remains adequate to cover all probable loan charge-offs that exist in the portfolio at that time. We assign qualitative and environmental factors (Q factors) to each loan category. Q factors include reserves held for the effects of lending policies, economic trends, and portfolio trends along with other dynamics which may cause additional stress to the portfolio.

Managing credits identified through the risk evaluation methodology includes developing a business strategy with the customer to mitigate our potential losses. Management continues to monitor these credits with a view to identifying as early as possible when, and to what extent, additional provisions may be necessary. See further discussion of the impact of the VCB acquisition on the allowance for credit losses in the Results of Operations Allowance for Credit Losses section below.

There were no additions made to the allowance for credit losses in 2013, compared to $700,000, and $1,050,000 for the same period in 2012, and 2011, respectively. These provisions are primarily the result of our assessment of the overall adequacy of the allowance for credit losses considering a number of factors as discussed in the "Allowance for Credit Losses" section below. The increase in unallocated reserves in the current period is primarily due to an additional risk factor which management is further analyzing related to the recent increase in long-term interest rates and the effects that higher rates may have on certain borrowers' debt service capabilities, particularly those with home equity loans. During the year ended December 31, 2013, the Company had net charge offs totaling $925,000 compared to $1,963,000 and $668,000 for the same periods in 2012 and 2011, respectively. The net charge off ratio, which reflects net charge-offs to average loans, was 0.20%, 0.48% and 0.16% for 2013, 2012, and 2011, respectively. The charged off loans were previously identified and adequately reserved for as of December 31, 2012. Nonperforming loans were $7,586,000 and $9,695,000 at December 31, 2013 and 2012, respectively. Nonperforming loans as a percentage of total loans were 1.48% at December 31, 2013 compared to 2.45% at December 31, 2012. There was other real estate owned in the amount of $190,000 at December 31, 2013 compared to none at December 31, 2012 and December 31, 2011.

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We had loans past due, not including non accrual loans, totaling $637,000 at December 31, 2013 compared to $27,000 at December 31, 2012. Losses in the loan portfolio and non-accruing balances remain elevated relative to historical periods and an increase in the level of charge-offs and the number and dollar volume of past due and nonperforming loans may result in further provisions to the allowance for credit losses.

We anticipate weakness in economic conditions on national, state and local levels to continue. Continued economic pressures may negatively impact the financial condition of borrowers to whom the Company has extended credit and as a result we may be required to make further significant provisions to the allowance for credit losses in the future. We have been and will continue to be proactive in looking for signs of deterioration within the loan portfolio in an effort to manage credit quality and work with borrowers where possible to mitigate any further losses.

As of December 31, 2013, we believe, based on all current and available information, the allowance for credit losses is adequate to absorb probable incurred losses within the loan portfolio. However, no assurance can be given that we may not sustain charge-offs which are in excess of the allowance in any given period. Refer to “Allowance for Credit Losses” below for further information.

Net Interest Income after Provision for Credit Losses

Net interest income, after the provision for credit losses of $0 in 2013, $700,000 in 2012, and $1,050,000 in 2011, was $33,451,000 for 2013 compared to $29,237,000 and $30,307,000 for 2012 and 2011, respectively.

Non-Interest Income

Non-interest income is comprised of customer service charges, gains on sales and calls of investment securities, income from appreciation in cash surrender value of bank owned life insurance, loan placement fees, Federal Home Loan Bank dividends, and other income. Non-interest income was $7,832,000 in 2013 compared to $7,242,000 and $6,271,000 in 2012 and 2011, respectively. The $590,000 or 8.15% increase in non-interest income was due to increases in service charge income, interchange fees, Federal Home Loan Bank dividends, and loan placement fees, partially offset by a decrease in gains on sales and calls of investment securities. The $971,000 or 15.48% increase in non-interest income comparing 2012 to 2011 was due to increases in gains on sales and calls of investment securities, and an increase in loan placement fees, partially offset by a decrease in gains on disposal of other real estate owned and a decrease in service charge income.

Customer service charges increased $382,000 to $3,156,000 in 2013 compared to $2,774,000 in 2012 and $2,903,000 in 2011. The increase in 2013 from 2012, and in 2012 from 2011 is mainly due to increases in overdraft and analyzed service charge fee income. The $382,000 increase in 2013 is due to the inclusion of VCB service charges of approximately $510,000 offset by a decrease in the legacy Company service charge income of 128,000.

During the year ended December 31, 2013, we realized net gain on sales and calls of investment securities of $1,265,000. In 2012, we realized a net gain of $1,639,000 compared to a net loss of $298,000 in 2011 from sales and calls of securities. The net gains in 2013 and 2012 were the results of partial restructuring of the investment portfolio designed to improve the future performance of the portfolio. For the year ended December 31, 2011, we realized a $31,000 other-than-temporary impairment write down on certain investment securities. See Footnote 4 to the audited Consolidated Financial Statements for more detail.

Income from the appreciation in cash surrender value of bank owned life insurance (BOLI) totaled $495,000 in 2013 compared to $391,000 and $382,000 in 2012 and 2011, respectively. The Bank’s salary continuation and deferred compensation plans and the related BOLI are used as a retention tool for directors and key executives of the Bank.

Interchange fees totaled $962,000 in 2013 compared to $767,000 and $758,000 in 2012 and 2011, respectively. Part of the increase in 2013 is attributable to the VCB acquisition.

We earn loan placement fees from the brokerage of single-family residential mortgage loans provided for the convenience of our customers. Loan placement fees increased $46,000 in 2013 to $677,000 compared to $631,000 in 2012 and $274,000 in 2011. Fees were higher in 2013 compared to 2012 and 2011. Refinancing and new mortgage activity increased in 2013 and 2012 due to the historically low mortgage rates, a decline in housing values and first time home buyer tax incentives.

The Bank holds stock from the Federal Home Loan Bank in relationship with its borrowing capacity and generally receives quarterly dividends. As of December 31, 2013, we held $4,499,000 in FHLB stock compared to $3,850,000 at December 31, 2012. Dividends in 2013 increased to $177,000 compared to $36,000 in 2012 and $9,000 in 2011. Other income increased to $1,100,000 in 2013 compared to $992,000 and $1,063,000 in 2012 and 2011, respectively. The period-to-period increase in 2013 compared to 2012 was primarily due to increases in electronic funds transfer fee income and non-customer check cashing fees.

Non-Interest Expenses

Salaries and employee benefits, occupancy and equipment, regulatory assessments,acquisition and integration-related expenses, data processing expenses, ATM/Debit card expenses, license and maintenance contract expenses, and professional services (consisting of audit, accounting, consulting and legal fees) are the major categories of non-interest expenses. Non-

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interest expenses increased $4,412,000 or 16.18% to $31,686,000 in 2013 compared to $27,274,000 in 2012, compared to $28,240,000 in 2011, which was a decrease of $966,000 in 2012.

Our efficiency ratio, measured as the percentage of non-interest expenses (exclusive of amortization of core deposit intangibles and other real estate owned expenses) to net interest income before provision for credit losses plus non-interest income (exclusive of realized gains or losses on sale and calls of investments) was 78.50% for 2013 compared to 75.99% for 2012 and 75.68% for 2011. The deterioration in the efficiency ratio in 2013 is due to an increase in operating expenses partially offset by an increase in net interest income. The decline in the efficiency ratio in 2012 compared to 2011 is due to a decrease in net interest income that is greater than the decrease in operating expenses.

Salaries and employee benefits increased $1,830,000 or 11.73% to $17,427,000 in 2013 compared to $15,597,000 in 2012 and $15,762,000 in 2011. Full time equivalents were 241 at December 31, 2013 compared to 208 at December 31, 2012.

At December 31, 2013, we had two share based compensation plans under which compensation expense is recognized based on the estimated fair value of the awards at the date of the grant. The Central Valley Community Bancorp 2000 Stock Option Plan (2000 Plan) for which 203,660 shares remain reserved for issuance for options already granted under incentive and nonstatutory agreements. This plan expired in November 2010 and no new options will be granted under this plan. The Central Valley Community Bancorp 2005 Omnibus Incentive Plan (2005 Plan) provides for awards in the form of incentive stock options, non-statutory stock options, stock appreciation rights, and restricted stock. Currently under the 2005 Plan, there are 176,770 shares reserved for issuance for options already granted to employees and directors.

The Company bases the fair value of the options previously granted on the date of grant using a Black-Scholes-Merton option pricing model that uses assumptions based on expected option life, the level of estimated forfeitures, expected stock volatility and the risk-free interest rate. Stock volatility is based on the historical volatility of the Company’s stock. The risk-free rate is based on the U.S. Treasury yield curve and the expected term of the options. The expected term of the options represents the period that the Company’s options are expected to be outstanding.

For the years ended December 31, 2013, 2012, and 2011, the compensation cost recognized for share based compensation was $98,000, $108,000 and $196,000, respectively.

As of December 31, 2013, there was $268,000 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the two plans. The cost is expected to be recognized over a weighted average period of 3.15 years. See Notes 1 and 15 to the audited Consolidated Financial Statements for more detail.

No options to purchase shares of the Company’s common stock were issued during the years ending December 31, 2013 and 2011. In 2012, options to purchase 92,150 shares of common stock were granted from the 2005 Plan at exercise prices between $8.02 and $8.75. All options were granted with an exercise price equal to the market value on the grant date.

Occupancy and equipment expense increased $531,000 or 14.84% to $4,109,000 in 2013 compared to $3,578,000 in 2012 and $3,795,000 in 2011. The increase in 2013 was primarily due to increases in rent and depreciation expense for the premises acquired from VCB. The Company made no changes in depreciation expense methodology.

Regulatory assessments decreased $44,000 or 6.75% to $696,000 in 2013 compared to $652,000 and $845,000 in 2012 and 2011, respectively. The FDIC finalized a new assessment system which took effect the third quarter of 2011. The final rule changed the assessment base from domestic deposits to average assets minus average tangible equity.

Acquisition and integration-related expenses increased $692,000 to $976,000 in 2013 compared to $284,000 in 2012, which were all related to the VCB acquisition. There were no acquisition and integration expenses in 2011.

Data processing expenses were $1,383,000 in 2013 compared to $1,125,000 in 2012 and $1,178,000 in 2011. The $258,000 or 22.93% increase in 2013, is the result of increased processing charges related to increase of accounts and services provided to our customers and branches. The $53,000 decrease in 2012 compared to 2011 was a result of a reduction in terms of our core processing contract.

Legal fees decreased $69,000 or 37.30% to $116,000 for the year ended December 31, 2013 compared to $185,000 and $335,000 in 2012 and 2011, respectively. The higher legal fees in 2012 and 2011 are primarily due to issues related to nonperforming assets and other loan related legal expenses.

Amortization of core deposit intangibles was $268,000 for 2013, $200,000 for 2012, and $414,000 for 2011. During 2013, amortization expense related to Service 1st Bank core deposit intangible (CDI) was $200,000, and amortization expense related to VCB CDI was $68,000. During 2012, CDI amortization expense related solely to Service 1st Bank CDI. Bank of Madera County CDI was fully amortized at the end of 2011. During 2011, CDI amortization expense included $200,000 for Service 1st Bank CDI and $214,000 for the Bank of Madera County CDI.

Consulting fees increased $299,000 to $461,000 for the year ended December 31, 2013 compared to $162,000 and $340,000 in 2012 and 2011, respectively. Higher consulting fees in 2013 related to costs for recruiting qualified candidates for a Bank President position and for support and defense for the Company’s tax examination.

ATM/Debit card expenses increased $158,000 to $527,000 for the year ended December 31, 2013 compared to $369,000 in 2012 and 2011. License and maintenance contracts increased $110,000 to $472,000 for the year ended December 31, 2013 compared to $362,000 and $324,000 in 2012 and 2011, respectively. Other non-interest expenses increased $576,000 or 15.62% to $4,264,000 in 2013 compared to $3,688,000 in 2012 and $3,652,000 in 2011, primarily due to the VCB acquisition.

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The following table describes significant components of other non-interest expense as a percentage of average assets.

For the years ended December 31, (Dollars in thousands)	Other Expense 2013	% Average Assets		Other Expense 2012	% Average Assets		Other Expense 2011	% Average Assets	
Internet banking expense	397	0.04	%	270	0.03	%	247	0.03	%
Stationery/supplies	257	0.03	%	221	0.03	%	245	0.03	%
Amortization of software	243	0.02	%	196	0.02	%	232	0.03	%
Director fees and related expenses	233	0.02	%	215	0.03	%	219	0.03	%
Telephone	219	0.02	%	169	0.02	%	236	0.03	%
Postage	202	0.02	%	183	0.02	%	198	0.02	%
Donations	160	0.02	%	148	0.02	%	154	0.02	%
Education/training	135	0.01	%	155	0.02	%	160	0.02	%
General insurance	126	0.01	%	120	0.01	%	125	0.01	%
Appraisal fees	89	0.01	%	77	0.01	%	112	0.01	%
Operating losses	67	0.01	%	85	0.01	%	125	0.01	%
Other	2,136	0.22	%	1,849	0.22	%	1,599	0.19	%
Total other non-interest expense	$4,264	0.43	%	$3,688	0.43	%	$3,652	0.43	%

Provision for Income Taxes

Our effective income tax rate was 14.04% for 2013 compared to 18.31% for 2012 and 22.32% for 2011. The Company reported an income tax provision of $1,347,000, $1,685,000, and $1,861,000 for the years ended December 31, 2013, 2012, and 2011, respectively. The decrease in the effective tax rate in 2013 compared to 2012 is due to an increase in interest income on non-taxable investment securities and the reversal of a reserve for prior years' uncertain tax positions. The Company maintains a reserve for uncertain income taxes in accordance with ASC 710-10-25 (formerly FIN 48). During the third quarter of 2013, the California Franchise Tax Board concluded the tax examination of the Company's 2008, 2009, and 2010 tax filings; and we accordingly reversed the unneeded reserve for those tax years. The Company has also benefited from tax credits and deductions related to the California enterprise zone program; however, those benefits will be reduced beginning January 1, 2014 due to the legislative changes affecting the program.. Our low effective tax rate is due primarily to federal tax deductions for tax free municipal bond income, solar tax credits, the state tax deduction for loans in designated enterprise zones in California, and state hiring tax credits.

Preferred Stock Dividends and Accretion

On August 18, 2011, the Company entered into a Securities Purchase Agreement (SPA) with the Small Business Lending Fund of the United States Department of the Treasury (the Treasury), under which the Company issued 7,000 shares of Senior Non-Cumulative Perpetual Preferred Stock, Series C (Series C Preferred) to the Treasury for an aggregate purchase price of $7,000,000. Simultaneously, the Company agreed with Treasury under a Letter Agreement to redeem, for an aggregate price of $7,000,000, the 7,000 shares of the Company's Series A Fixed Rate Cumulative Preferred Stock (Series A Stock) originally issued pursuant to the Treasury's Capital Purchase Program (CPP) in 2009. The redemption of the Series A Stock resulted in an acceleration of the remaining discount booked at the time of the CPP transaction. In connection with the repurchase of the Series A Stock, the Company also repurchased the warrant (the Warrant) to purchase 79,037 shares of the Company's common stock that was originally issued to Treasury in connection with the CPP transaction for total consideration of $185,000.

On December 31, 2013, the Company redeemed all 7,000 outstanding shares of its Series C Preferred from the Treasury, in exercise of its optional redemption rights pursuant to the terms of the Series C Preferred under the Company's charter and the SPA. The Company paid the Treasury $7,087,500 in connection with the redemption, representing $1,000 per share of the Series C Preferred plus all accrued and unpaid dividends through the date of the redemption. The obligations of the Company under the SPA are terminated as a result of the redemption. No additional shares of Series C Preferred are outstanding.

We accrued preferred stock dividends to the Treasury and accretion of the issuance discount in the amount of $350,000 and $350,000 during the years ended December 31, 2013 and 2012, respectively.

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Summary of Changes in Consolidated Balance Sheets

December 31, 2013 compared to December 31, 2012.

Total assets were $1,145,635,000 as of December 31, 2013, compared to $890,228,000 as of December 31, 2012, an increase of 28.69% or $255,407,000. Total gross loans were $512,357,000 as of December 31, 2013, compared to $395,318,000 as of December 31, 2012, an increase of $117,039,000 or 29.61%. The total investment portfolio (including Federal funds sold and interest-earning deposits in other banks) increased 24.71% or $104,882,000 to $529,398,000. Total deposits increased 33.63% or $252,711,000 to $1,004,143,000 as of December 31, 2013, compared to $751,432,000 as of December 31, 2012. Shareholders’ equity increased $2,378,000 or 2.02% to $120,043,000 as of December 31, 2013, compared to $117,665,000 as of December 31, 2012. The increase in shareholders' equity was driven by the issuance of stock as part of the Visalia Community Bank (VCB) acquisition and a net increase in retained earnings partially offset by decreases in other accumulated other comprehensive income (AOCI) and preferred stock. Accrued interest payable and other liabilities were $16,294,000 as of December 31, 2013, compared to $11,976,000 as of December 31, 2012, an increase of $4,318,000. The balance sheet increases during 2013 were primarily driven by the VCB acquisition which closed on July 1, 2013.

Fair Value

The Company measures the fair values of its financial instruments utilizing a hierarchical framework associated with the level of observable pricing scenarios utilized in measuring financial instruments at fair value. The degree of judgment utilized in measuring the fair value of financial instruments generally correlates to the level of the observable pricing scenario. Financial instruments with readily available actively quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of observable pricing and a lesser degree of judgment utilized in measuring fair value. Conversely, financial instruments rarely traded or not quoted will generally have little or no observable pricing and a higher degree of judgment utilized in measuring fair value. Observable pricing scenarios are impacted by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established and the characteristics specific to the transaction.
See Note 3 of the Notes to Consolidated Financial Statements for additional information about the level of pricing transparency associated with financial instruments carried at fair value.

Investments

Our investment portfolio consists primarily of U.S. Government sponsored entities and agencies collateralized by residential mortgage backed obligations and obligations of states and political subdivision securities and are classified at the date of acquisition as available for sale or held to maturity. As of December 31, 2013, investment securities with a fair value of $99,209,000, or 22.38% of our investment securities portfolio, were held as collateral for public funds, short and long-term borrowings, treasury, tax, and for other purposes. Our investment policies are established by the Board of Directors and implemented by our Investment/Asset Liability Committee. They are designed primarily to provide and maintain liquidity, to enable us to meet our pledging requirements for public money and borrowing arrangements, to generate a favorable return on investments without incurring undue interest rate and credit risk, and to complement our lending activities.
The level of our investment portfolio is generally considered higher than our peers due primarily to a comparatively low loan to deposit ratio. Our loan to deposit ratio at December 31, 2013 was 51.02% compared to 52.61% at December 31, 2012. The loan to deposit ratio of our peers was 70.41% at September 30, 2013. Peer group information from SNL Financial data includes bank holding companies in central California with assets from $300 million to $1.2 billion that are not subchapter S corporations. The total investment portfolio, including Federal funds sold and interest-earning deposits in other banks, increased 24.71% or $104,882,000 to $529,398,000 at December 31,

2013, from $424,516,000 at December 31, 2012. The market value of the portfolio reflected an unrealized loss of $3,884,000 at December 31, 2013, compared to an unrealized gain of $12,891,000 at December 31, 2012.

We periodically evaluate each investment security for other-than-temporary impairment, relying primarily on industry analyst reports, observation of market conditions and interest rate fluctuations. Under ASC 320-10, the portion of the impairment that is attributable to a shortage in the present value of expected future cash flows relative to the amortized cost should be recorded as a current period charge to earnings. The discount rate in this analysis is the original yield expected at time of purchase.

As of December 31, 2013, the Company performed an analysis of the investment portfolio to determine whether any of the investments held in the portfolio had an other-than-temporary impairment (OTTI). Management evaluated all available-for-sale investment securities with an unrealized loss at December 31, 2013, and identified those that had an unrealized loss for at least a consecutive 12 month period, which had an unrealized loss at December 31, 2013 greater than

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10% of the recorded book value on that date, or which had an unrealized loss of more than $10,000. Management also analyzed any securities that may have been down graded by credit rating agencies.

For those bonds that met the evaluation criteria management obtained and reviewed the most recently published national credit ratings for those bonds. For those bonds that were municipal debt securities with an investment grade rating by the rating agencies, management also evaluated the financial condition of the municipality and any applicable municipal bond insurance provider and concluded that no credit related impairment existed.

At December 31, 2013, the Company had a total of 21 PLRMBS with a remaining principal balance of $4,344,000 and a net unrealized gain of approximately $1,047,000. Eight of these PLRMBS with a remaining principal balance of $3,400,000 had credit ratings below investment grade. The Company continues to perform extensive analyses on these securities as well as all whole loan CMOs. No credit related OTTI charges related to PLRMBS were recorded during the year ended December 31, 2013.

See Note 4 to the audited Consolidated Financial Statements for carrying values and estimated fair values of our investment securities portfolio.

Loans

Total gross loans increased $117,039,000 or 29.61% to $512,357,000 as of December 31, 2013, compared to $395,318,000 as of December 31, 2012.

The following table sets forth information concerning the composition of our loan portfolio as of and for the years ended December 31, 2013, 2012, 2011, 2010, and 2009.

Loan Type (Dollars in thousands)	2013 Amount	2013 % of Total Loans	2012 Amount	2012 % of Total Loans	2011 Amount	2011 % of Total Loans	2010 Amount	2010 % of Total Loans	2009 Amount	2009 % of Total Loans
Commercial:										
Commercial and industrial	$87,082	17.0 %	$77,956	19.7 %	$78,089	18.3 %	$81,318	18.8 %	$93,282	20.3 %
Agricultural land and production	31,649	6.1 %	26,599	6.7 %	29,958	7.0 %	20,604	4.8 %	13,903	3.0 %
Total commercial	118,731	23.1 %	104,555	26.4 %	108,047	25.3 %	101,922	23.6 %	107,185	23.3 %
Real estate:										
Owner occupied	156,781	30.6 %	114,444	28.9 %	113,183	26.4 %	111,888	25.9 %	106,606	23.2 %
Real estate-construction and other land loans	42,329	8.3 %	33,199	8.4 %	33,047	7.7 %	32,038	7.4 %	51,633	11.2 %
Commercial real estate	86,117	16.8 %	53,797	13.6 %	62,523	14.6 %	63,627	14.7 %	71,420	15.6 %
Agricultural real estate	44,164	8.6 %	28,400	7.2 %	42,596	9.9 %	44,397	10.3 %	38,759	8.4 %
Other real estate	4,548	0.9 %	8,098	2.0 %	7,892	1.8 %	8,103	1.9 %	4,610	1.0 %
Total real estate	333,939	65.2 %	237,938	60.1 %	259,241	60.4 %	260,053	60.2 %	273,028	59.4 %
Consumer:										
Equity loans and lines of credit	48,594	9.5 %	42,932	10.9 %	51,106	12.0 %	58,860	13.6 %	65,353	14.2 %
Consumer and installment	11,252	2.2 %	10,346	2.6 %	9,765	2.3 %	11,261	2.6 %	14,033	3.1 %
Total consumer	59,846	11.7 %	53,278	13.5 %	60,871	14.3 %	70,121	16.2 %	79,386	17.3 %
Deferred loan fees, net	(159)		(453)		(764)		(499)		(392)	
Total gross loans	512,357	100.0%	395,318	100.0%	427,395	100.0%	431,597	100.0%	459,207	100.0%
	(9,208)		(10,133)		(11,396)		(11,014)		(10,200)	

Allowance for credit losses					
Total loans	$503,149	$385,185	$415,999	$420,583	$449,007

At December 31, 2013, loans acquired in the VCB acquisition had a balance of $99,948,000, of which $12,686,000 were commercial loans, $71,833,000 were real estate loans, and $15,429,000 were consumer loans.
At December 31, 2013, in management's judgment, a concentration of loans existed in commercial loans and real-estate-related loans, representing approximately 97.8% of total loans of which 23.1% were commercial and 74.7% were real-estate-related. This level of concentration is consistent with 97.4% at December 31, 2012. Although we believe the loans within this concentration have no more than the normal risk of collectibility, a substantial further decline in the performance of the economy in general or a further decline in real estate values in our primary market areas, in particular, could have an adverse impact on collectibility, increase the level of real estate-related nonperforming loans, or have other adverse effects which alone or in the aggregate could have a material adverse effect on our business, financial condition, results of operations and cash flows. The Company was not involved in any sub-prime mortgage lending activities at December 31, 2013 and 2012.

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We believe that our commercial real estate loan underwriting policies and practices result in prudent extensions of credit, but recognize that our lending activities result in relatively high reported commercial real estate lending levels. Commercial real estate loans include certain loans which represent low to moderate risk and certain loans with higher risks.

The Board of Directors review and approve concentration limits and exceptions to limitations of concentration are reported to the Board of Directors at least quarterly.

Nonperforming Assets

Nonperforming assets consist of loans past due 90 days or more that are still accruing interest, loans on nonaccrual status, and foreclosed property classified as Other Real Estate Owned (OREO). We measure all loans placed on nonaccrual status for impairment based on the fair value of the underlying collateral or the net present value of the expected cash flows.

At December 31, 2013, total nonperforming assets totaled $7,776,000, or 0.68% of total assets, compared to $9,695,000, or 1.09% of total assets at December 31, 2012. Total nonperforming assets at December 31, 2013, included nonaccrual loans totaling $7,586,000, $190,000 in OREO, and no repossessed assets. Nonperforming assets at December 31, 2012 consisted of $9,695,000 in nonaccrual loans and no OREO or repossessed assets. At December 31, 2013, we had ten loans considered troubled debt restructurings (“TDRs”) totaling $4,595,000 which are included in nonaccrual loans compared to seven TDRs totaling $9,245,000 at December 31, 2012. We have no outstanding commitments to lend additional funds to any of these borrowers.

A summary of nonaccrual, restructured, and past due loans at December 31, 2013 and 2012 is set forth below. The Company had no loans past due more than 90 days and still accruing interest at December 31, 2013 and 2012. Management is not aware of any potential problem loans, which were current and accruing at December 31, 2013, where serious doubt exists as to the ability of the borrower to comply with the present repayment terms. Management can give no assurance that nonaccrual and other nonperforming loans will not increase in the future.

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Composition of Nonaccrual, Past Due and Restructured Loans

(Dollars in thousands)	December 31, 2013	December 31, 2012	December 31, 2011	December 31, 2010	December 31, 2009
Nonaccrual Loans					
Commercial and industrial	$335	$—	$267	$377	$2,868
Owner occupied	1,777	213	353	1,407	2,218
Real estate construction and other land loans	—	—	—	5,634	7,691
Commercial real estate	158	—	2,434	—	965
Equity loans and line of credit	721	237	705	488	301
Consumer and installment	—	—	74	—	348
Restructured loans (non-accruing)					
Commercial and industrial	1,192	—	—	1,978	28
Owner occupied	384	1,362	1,019	2,370	2,282
Real estate construction and other land loans	1,450	6,288	6,823	2,193	2,214
Commercial real estate	—	—	1,110	1,828	—
Other real estate	—	—	—	2,286	—
Equity loans and line of credit	1,565	1,595	1,649	—	44
Consumer and Installment	4	—	—	—	—
Total nonaccrual	7,586	9,695	14,434	18,561	18,959
Accruing loans past due 90 days or more	—	—		—	—
Total nonperforming loans	$7,586	$9,695	$14,434	$18,561	$18,959
Nonperforming loans to total loans	1.48 %	2.45 %	3.38 %	4.30 %	4.13 %
Ratio of nonperforming loans to allowance for credit losses	82.38 %	95.68 %	126.66 %	168.52 %	185.87 %
Loans considered to be impaired	$13,357	$17,105	$23,644	$18,561	$18,959
Related allowance for credit losses on impaired loans	$1,007	$510	$4,368	$2,124	$752

We measure our impaired loans by using the fair value of the collateral if the loan is collateral dependent and the present value of the expected future cash flows discounted at the loan's original contractual interest rate if the loan is not collateral dependent. As of December 31, 2013 and 2012, we had impaired loans totaling $13,357,000 and $17,105,000, respectively. For collateral dependent loans secured by real estate, we obtain external appraisals which are updated at least annually to determine the fair value of the collateral, and we record an immediate charge off for the difference between the book value of the loan and the appraised less selling costs value of the collateral. We perform quarterly internal reviews on substandard loans. We place loans on nonaccrual status and classify them as impaired when it becomes probable that we will not receive interest and principal under the original contractual terms, or when loans are delinquent 90 days or more unless the loan is both well secured and in the process of collection. Management maintains certain loans that have been brought current by the borrower (less than 30 days delinquent) on nonaccrual status until such time as management has determined that the loans are likely to remain current in future periods. Foregone interest on nonaccrual loans totaled $661,000 for the year ended December 31, 2013 of which $279,000 was attributable to troubled debt restructurings. Foregone interest on nonaccrual loans totaled $693,000 and $954,000 for the years ended December 31, 2012 and 2011, respectively of which $669,000 and $769,000 was attributable to troubled debt restructurings, respectively.

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The following table provides a reconciliation of the change in non-accrual loans for the year ended December 31, 2013.

(Dollars in thousands)	Balances December 31, 2012	Additions to Nonaccrual Loans	Net Pay Downs	Transfer to Foreclosed Collateral - OREO	Returns to Accrual Status	Charge Offs	Balances December 31, 2013
Non-accrual loans:							
Commercial and industrial	$—	$389	$(54)	$—	$—	$—	$335
Real estate	213	1,847	(125)	—	—	—	1,935
Equity loans and lines of credit	237	1,013	(66)	(190)	—	(273)	721
Consumer	—	9	(2)	—	(7)	—	—
Restructured loans (non-accruing):							
Commercial and industrial	—	2,100	(211)	—	—	(697)	1,192
Real estate	1,362	7	(65)	—	(920)	—	384
Real estate construction and land development	6,288	285	(5,123)	—	—	—	1,450
Equity loans and lines of credit	1,595	111	(141)	—	—	—	1,565
Consumer	—	5	(1)	—	—	—	4
Total non-accrual	$9,695	$5,766	$(5,788)	$(190)	$(927)	$(970)	$7,586

The following table provides a summary of the annual change in the OREO balance:

	Years Ended December 31,	
(Dollars in thousands)	2013	2012
Balance, Beginning of year	$—	$—
Additions	453	2,337
Dispositions	(263)	(2,349)
Write-downs	—	—
Net gain on disposition	—	12
Balance, End of year	$190	$—

OREO represents real property taken either through foreclosure or through a deed in lieu thereof from the borrower. OREO is carried at the lesser of cost or fair market value, less selling costs. As of December 31,2013 the Company had $190,000 in OREO property which was subsequently sold for book value during January 2014. As of December 31, 2012, the Company had no OREO properties.

Allowance for Credit Losses

We have established a methodology for the determination of provisions for credit losses made up of general and specific allocations. The methodology is set forth in a formal policy and takes into consideration the need for an overall allowance for credit losses as well as specific allowances that are tied to individual loans. The allowance for credit losses is an estimate of probable credit losses inherent in the Company's loan portfolio as of the balance-sheet date. The allowance consists of two primary components, specific reserves related to impaired loans and general reserves for inherent losses related to loans that are not impaired.

For all portfolio segments, the determination of the general reserve for loans that are not impaired is based on estimates made by management, including but not limited to, consideration of historical losses by portfolio segment over the most recent 20 quarters, and qualitative factors including economic trends in the Company's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio taken as a whole. During the first quarter of 2013, management determined that the most recent 20 quarters was an appropriate look back period based on several factors

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including the current global economic uncertainty and various national and local economic indicators. The impact to the general reserve, as a result of moving from a 16 quarter rolling average to a 20 quarter rolling average, did not have a material impact on the level of allowance required, but it did ensure that the significant loss years for the Bank would continue to be factored into the general reserve analysis. Management determined that it was necessary to expand the average period to capture enough data due to the size of the portfolio to produce statistically accurate historical loss calculations. We believe this period is an appropriate look back period.

In originating loans, we recognize that losses will be experienced and that the risk of loss will vary with, among other things, the type of loan being made, the creditworthiness of the borrower over the term of the loan, general economic conditions and, in the case of a secured loan, the quality of the collateral securing the loan. The allowance is increased by provisions charged against earnings and reduced by net loan charge offs. Loans are charged off when they are deemed to be uncollectible, or partially charged off when portions of a loan are deemed to be uncollectible. Recoveries are generally recorded only when cash payments are received.

The allowance for credit losses is maintained to cover probable incurred losses inherent in the loan portfolio. The responsibility for the review of our assets and the determination of the adequacy lies with management and our Audit Committee. They delegate the authority to the Chief Credit Administrator (CCA) to determine the loss reserve ratio for each type of asset and to review, at least quarterly, the adequacy of the allowance based on an evaluation of the portfolio, past experience, prevailing market conditions, amount of government guarantees, concentration in loan types and other relevant factors.

The allowance for credit losses is an estimate of the probable incurred losses in our loan and lease portfolio as of the balance sheet date. The allowance is based on principles of accounting: (1) ASC 450-20 which requires losses to be accrued for on loans when they are probable of occurring and can be reasonably estimated and (2) ASC 310-10 which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

Credit Administration adheres to an internal asset review system and loss allowance methodology designed to provide for timely recognition of problem assets and adequate valuation allowances to cover expected asset losses. The Bank's asset monitoring process includes the use of asset classifications to segregate the assets, largely loans and real estate, into various risk categories. The Bank uses the various asset classifications as a means of measuring risk and determining the adequacy of valuation allowances by using a nine-grade system to classify assets. All credit facilities exceeding 90 days of delinquency require classification and are placed on nonaccrual.

The following table sets forth information regarding our allowance for credit losses at the dates and for the periods indicated:

	Years Ended December 31,			
(Dollars in thousands)	2013		2012	
Balance, beginning of year	$10,133		$11,396	
Provision charged to operations	—		700	
Losses charged to allowance	(1,446	)	(2,850	)
Recoveries	521		887	
Balance, end of year	$9,208		$10,133	
Allowance for credit losses to total loans	1.80	%	2.56	%

As of December 31, 2013, the balance in the allowance for credit losses was $9,208,000 compared to $10,133,000 as of December 31, 2012. The decrease was due to net charge offs during the year ended December 31, 2013 being greater than the amount of the provision for credit losses. Net charge offs totaled $925,000 while the provision for credit losses was $0. Loans charged off in 2013 were fully reserved at December 31, 2012. The balance of commitments to extend credit on undisbursed construction and other loans and letters of credit was $192,667,000 as of December 31, 2013, compared to $162,851,000 as of December 31, 2012. At December 31, 2013, the balance of a contingent allocation for probable loan loss experience on unfunded obligations was $141,000. The contingent allocation for probable loan loss experience on unfunded obligations is calculated by management using appropriate, systematic, and consistently applied process. While related to credit losses, this allocation is not a part of ALLL and is considered separately as a liability for accounting and regulatory reporting purposes. Risks and uncertainties exist in all lending transactions and our management and Directors' Loan Committee have established reserve levels based on economic uncertainties and other risks that exist as of each reporting period.

As of December 31, 2013, the allowance for credit losses was 1.80% of total gross loans compared to 2.56% as of December 31, 2012. During the year ended December 31, 2013, there were no major changes in loan concentrations that significantly affected the allowance for credit losses. The decrease in the ALLL as a percentage of total loans is primarily due to the inclusion of $99,948,000 from VCB loans that were recorded at fair value in connection with the acquisition and therefore have no related allowance. Excluding these VCB loans from the calculation, the allowance for credit losses to total gross loans as of December 31, 2013 was 2.23%. The increase in loan totals was driven primarily by an increase in agricultural loans which have a favorable loss history and from the loans acquired as part of the VCB acquisition. Approximately $2,000,000 in VCB loan balances and an additional $4,850,000 in unfunded commitments were refinanced during the later half of 2013, which decreased the allowance allocation by approximately $300,000 as of December 31, 2013.

The 2013 decrease in the ALLL balance was due to improvement in our historical losses along with improvements in the risk and composition of the loan portfolio. Historic loss rates declined substantially, as high-loss quarters began dropping off from the five-year moving average. Qualitative factors also declined to reflect the trends in losses, improvements in the general economy, and the lower level of substandard loans.

The determination of the general reserve for loans that are not impaired is based on estimates made by management, including but not limited to, consideration of historical losses by portfolio segment over the most recent 20 quarters, and qualitative factors. The increase in unallocated reserves in the current period is primarily due to an additional risk factor which management is further analyzing related to the recent increase in long-term interest rates and the effects that higher rates may have on certain borrowers' debt service capabilities, particularly those with home equity loans.

During the period ended December 31, 2012, the Company enhanced the process for estimating the allowance for credit losses related to impaired loans through inclusion of the use of the discounted cash flow method on certain credits where sufficient payment history exists and future payments can be reasonably projected based on a global borrower cash flow analysis in addition to collateral dependent analysis. The modification did not have a significant impact on the amount of the allowance for credit losses in total nor did it have a material impact on the allocation of the allowance within loan categories. Q factors include reserves held for the effects of lending policies, economic trends, and portfolio trends along with other dynamics which may cause additional stress to the portfolio.

Assumptions regarding the collateral value of various under-performing loans may affect the level and allocation of the allowance for credit losses in future periods. The allowance may also be affected by trends in the amount of charge offs experienced or expected trends within different loan portfolios.

Non-performing loans totaled $7,586,000 as of December 31, 2013, and $9,695,000 as of December 31, 2012. The allowance for credit losses as a percentage of nonperforming loans was 121.38% and 104.52% as of December 31, 2013 and December 31, 2012, respectively. Management believes the allowance at December 31, 2013 is adequate based upon its ongoing analysis of the loan portfolio, historical loss trends and other factors. However, no assurance can be given that the Company may not sustain charge-offs which are in excess of the allowance in any given period.

Goodwill and Intangible Assets

Business combinations involving the Bank's acquisition of the equity interests or net assets of another enterprise give rise to goodwill. Total goodwill at December 31, 2013 was $29,917,000 compared to $23,577,000 at December 31, 2012. The total goodwill at December 31, 2013 consisted of $6,340,000, $14,643,000 and $8,934,000 representing the excess of the cost of Visalia Community Bank, Service 1st Bancorp and Bank of Madera County, respectively, over the net of the amounts assigned to assets acquired and liabilities assumed in the transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Bank's ability to generate net earnings after the acquisitions and is not deductible for tax purposes. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed at least annually for impairment.

The Company has selected September 30 as the date to perform the annual impairment test. Management assessed qualitative factors including performance trends and noted no factors indicating goodwill impairment.

Goodwill is also tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the Company below its carrying amount. No such events or circumstances arose during the fourth quarter of 2013, so goodwill was not required to be retested.

The intangible assets at December 31, 2013 represent the estimated fair value of the core deposit relationships acquired in the 2008 acquisition of Service 1st Bank of $1,400,000 and the 2013 acquisition of Visalia Community

Bank of $1,365,000. Core deposit intangibles are being amortized using the straight-line method over an estimated life of seven to ten years from the date of acquisition. The carrying value of intangible assets at December 31, 2013 was $1,680,000, net of $1,085,000 in accumulated amortization expense. The carrying value at December 31, 2012 was $583,000, net of $817,000 in accumulated amortization expense. Management evaluates the remaining useful lives quarterly to determine whether events or circumstances warrant a revision to the remaining periods of amortization. Based on the evaluation, no changes to the remaining useful lives was required. Management performed an annual impairment test on core deposit intangibles as of September 30, 2013 and determined no impairment was necessary. Amortization expense recognized was $268,000 for 2013, $200,000 for 2012 and $414,000 2011. $214,000 of the 2011 amortization was the remaining amortization for the Bank of Madera County core deposit intangible. The core deposit intangible from the 2005 acquisition of Bank of Madera County was fully amortized as of December 31, 2011.

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The following table summarizes the Company's estimated core deposit intangible amortization expense for each of the next five years (in thousands):

Years Ending December 31,	Estimated Core Deposit Intangible Amortization
2014	$337
2015	320
2016	137
2017	137
2018	137
Thereafter	612
Total	$1,680

Deposits and Borrowings

The Bank's deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to applicable legal limits. The FDIC's unlimited deposit insurance coverage on non-interest bearing transaction accounts mandated by the Dodd-Frank Act ended December 31, 2012. Beginning January 1, 2013, all of a depositors' accounts at an insured depository institution, including all non-interest bearing transactions accounts, will be insured by the FDIC up to the standard maximum deposit insurance amount of $250,000 for each deposit insurance ownership category.
Total deposits increased $252,711,000 or 33.63% to $1,004,143,000 as of December 31, 2013, compared to $751,432,000 as of December 31, 2012. Interest-bearing deposits increased $136,488,000 or 26.70% to $647,751,000 as of December 31, 2013, compared to $511,263,000 as of December 31, 2012. Non-interest bearing deposits increased $116,223,000 or 48.39% to $356,392,000 as of December 31, 2013, compared to $240,169,000 as of December 31, 2012. These deposit increases are primarily related to the VCB acquisition which closed on July 1, 2013. Approximately $174 million in deposits were recorded as a part of the acquisition. Average non-interest bearing deposits to average total deposits was 33.47% for the year ended December 31, 2013 compared to 30.23% for the same period in 2012. Our total market share of deposits in Fresno, Madera, and San Joaquin counties was 3.50% in 2013 compared to 3.58% in 2012 based on FDIC deposit market share information published as of June 2013.

The composition of the deposits and average interest rates paid at December 31, 2013 and December 31, 2012 is summarized in the table below.

(Dollars in thousands)	December 31, 2013	% of Total Deposits	Effective Rate	December 31, 2012	% of Total Deposits	Effective Rate
NOW accounts	$ 182,364	18.2 %	0.15 %	$ 161,328	21.4 %	0.19 %
MMA accounts	234,515	23.3 %	0.12 %	173,486	23.1 %	0.22 %
Time deposits	168,954	16.8 %	0.48 %	136,876	18.2 %	0.64 %
Savings deposits	61,918	6.2 %	0.08 %	39,573	5.3 %	0.09 %
Total interest-bearing	647,751	64.5 %	0.22 %	511,263	68.0 %	0.32 %
Non-interest bearing	356,392	35.5 %		240,169	32.0 %	
Total deposits	$ 1,004,143	100.0 %		$ 751,432	100.0 %	

There were no short term borrowings as of December 31, 2013, compared to $4,000,000 as of December 31, 2012 which represented FHLB advances with a weighted average interest of 3.59% and weighted average maturity of 0.1 years.
There were no long-term FHLB borrowings outstanding at December 31, 2013 or December 31, 2012. We maintain a line of credit with the FHLB collateralized by government securities and loans. Refer to Liquidity section below for further discussion of FHLB advances.
The Company succeeded to all of the rights and obligations of Service 1st Capital Trust I, a Delaware business trust, in connection with the acquisition of Service 1st as of November 12, 2008. The Trust was formed on August 17, 2006 for the sole purpose of issuing trust preferred securities fully and unconditionally guaranteed by Service 1st. Under

applicable regulatory guidance, the amount of trust preferred securities that is eligible as Tier 1 capital is limited to 25% of the Company's Tier 1 capital on a pro forma basis. At December 31, 2013, all of the trust preferred securities that have been issued qualify as Tier 1 capital. The trust preferred securities mature on October 7, 2036, are redeemable at the Company's option beginning after five years, and require quarterly distributions by the Trust to the holder of the trust preferred securities at a variable interest rate which will adjust quarterly to equal the three month LIBOR plus 1.60%.

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The Trust used the proceeds from the sale of the trust preferred securities to purchase approximately $5,155,000 in aggregate principal amount of Service 1st's junior subordinated notes (the Notes). The Notes bear interest at the same variable interest rate during the same quarterly periods as the trust preferred securities. The Notes are redeemable by the Company on any January 7, April 7, July 7, or October 7 on or after October 7, 2012 or at any time within 90 days following the occurrence of certain events, such as: (i) a change in the regulatory capital treatment of the Notes (ii) in the event the Trust is deemed an investment company or (iii) upon the occurrence of certain adverse tax events. In each such case, the Company may redeem the Notes for their aggregate principal amount, plus any accrued but unpaid interest.

The Notes may be declared immediately due and payable at the election of the trustee or holders of 25% of the aggregate principal amount of outstanding Notes in the event that the Company defaults in the payment of any interest following the nonpayment of any such interest for 20 or more consecutive quarterly periods. Holders of the trust preferred securities are entitled to a cumulative cash distribution on the liquidation amount of $1,000 per security. For each January 7, April 7, July 7 or October 7 of each year, the rate will be adjusted to equal the three month LIBOR plus 1.60%. As of December 31, 2013, the rate was 1.84%. Interest expense recognized by the Company for the years ended December 31, 2013, 2012, and 2011 was $98,000, $107,000 and $100,000, respectively.

Capital Resources

Capital serves as a source of funds and helps protect depositors and shareholders against potential losses. Historically, the primary source of capital for the Company has been internally generated capital through retained earnings. In addition to net income, capital increased in 2009 from the issuance of preferred stock and warrants under the Treasury Capital Purchase Program and preferred stock and common stock issued to accredited investors. In 2008, in addition to net income, capital increased from common stock issued for the acquisition of Service 1st Bancorp.

The Company has historically maintained substantial levels of capital. The assessment of capital adequacy is dependent on several factors including asset quality, earnings trends, liquidity and economic conditions. Maintenance of adequate capital levels is integral to providing stability to the Company. The Company needs to maintain substantial levels of regulatory capital to give it maximum flexibility in the changing regulatory environment and to respond to changes in the market and economic conditions.

Our shareholders' equity was $120,043,000 as of December 31, 2013, compared to $117,665,000 as of December 31, 2012. The increase in shareholders' equity is the result of increase in retained earnings from net income of $8,250,000, issuance of common stock as a part of the VCB acquisition of $12,494,000, exercise of stock options, including the related tax benefit of $806,000, and the effect of share based compensation expense of $98,000 offset by a decrease in accumulated other comprehensive income (AOCI) of $9,872,000, redemption of preferred stocked of $7,000,000, preferred stock dividends of $350,000, and common stock cash dividends of $2,048,000.

On December 23, 2009, the Company entered into Stock Purchase Agreements (Agreements) with a limited number of accredited investors (collectively, the Purchasers) to sell to the Purchasers a total of 1,264,952 shares of common stock, (Common Stock) at $5.25 per share and 1,359 shares of non-voting Series B Convertible Adjustable Rate Non-Cumulative Perpetual Preferred Stock (Series B Preferred Stock) at $1,000 per share, for an aggregate gross purchase price of $8,000,000 (the Offering) offset by issuance costs totaling $242,000.

In May 2010, the shareholders of the Company approved an amendment to the Company's governing instruments to create a series of non-voting common stock. In June 2010, the Company exercised its option to require the Purchasers to exchange the 1,359 shares of Series B Preferred Stock for 258,862 shares of non-voting common stock. In August 2011, the Company agreed to exchange the 258,862 shares of the Company's non-voting common stock to 258,862 shares of the Company's voting common stock. The issuance of voting common stock was conducted in a privately negotiated transaction exempt from registration pursuant to Sections 3(a)(9) and 4(2) of the Securities Act of 1933, as amended. No shares of Series B Preferred Stock or non-voting common stock remain outstanding. See Note 14 to the audited Consolidated Financial Statements in this report for a more detailed discussion.

On August 18, 2011, the Company entered into a Securities Purchase Agreement (SPA) with the Small Business Lending Fund of the United States Department of the Treasury (the Treasury), under which the Company issued 7,000

shares of Senior Non-Cumulative Perpetual Preferred Stock, Series C (the Preferred Shares) to the Treasury for an aggregate purchase price of $7,000,000. Simultaneously, the Company agreed with Treasury under a Letter Agreement to redeem, for an aggregate price of $7,000,000, the 7,000 shares of the Company's Series A Fixed Rate Cumulative Preferred Stock (Series A Stock) originally issued pursuant to the Treasury's Capital Purchase Program (CPP) in 2009. The redemption of the Series A Stock resulted in an acceleration of the remaining discount booked at the time of the CPP transaction. In connection with the repurchase of the Series A Stock, the Company also repurchased the warrant (the Warrant) to purchase 79,037 shares of the Company's common stock that was originally issued to Treasury in connection with the CPP transaction for total consideration of $185,000. See Note 14 to the audited Consolidated Financial Statements in this report for a more detailed discussion.
On August 15, 2012, the Board of Directors of the Company approved the adoption of a program to effect repurchases of the Company's common stock. Under the program, the Company was to repurchase up to five percent of the

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Company's outstanding shares of common stock, or approximately 479,850 shares based on the shares outstanding as of August 15, 2012, for the period beginning on August 15, 2012, and ending February 15, 2013. During 2012, the Company repurchased and retired a total of 58,100 shares at an average price of $8.41 for a total cost of $488,000. The stock repurchase program was suspended after the Company entered into a Reorganization Agreement and Plan of Merger (the Merger Agreement) with Visalia Community Bank on December 19, 2012.

During 2013, the Bank declared and paid cash dividends to the Company in the amount of $18,000,000 in connection with the VCB acquisition, the Series C Preferred redemption, and cash dividends to the Company's shareholders approved by the Company's Board of Directors. The Bank may not pay any dividend that would cause it to be deemed not "well capitalized" under applicable banking laws and regulations. The Company declared and paid a total of $2,048,000 or $0.20 per common share cash dividend to shareholders of record during the year ended December 31, 2013.

During 2012, the Bank declared and paid cash dividends to the Company of $3,000,000, in connection with stock repurchase agreements and cash dividends approved by the Company's Board of Directors. On October 17, 2012, the Company declared a $0.05 per common share cash dividend to shareholders of record at the close of business on November 15, 2012 which was paid on November 30, 2012. No dividends on common shares were declared in 2011.

Management considers capital requirements as part of its strategic planning process. The strategic plan calls for continuing increases in assets and liabilities, and the capital required may therefore be in excess of retained earnings. The ability to obtain capital is dependent upon the capital markets as well as our performance. Management regularly evaluates sources of capital and the timing required to meet its strategic objectives. The assessment of capital adequacy is dependent on several factors including asset quality, earnings trends, liquidity and economic conditions. Maintenance of adequate capital levels is integral to providing stability to the Company. The Company needs to maintain substantial levels of regulatory capital to give it maximum flexibility in the changing regulatory environment and to respond to changes in the market and economic conditions including acquisition opportunities.

The following table presents the Company's and the Bank's Regulatory capital ratios as of December 31, 2013 and December 31, 2012.

	December 31, 2013			December 31, 2012		
(Dollars in thousands)	Amount	Ratio		Amount	Ratio	
Tier 1 Leverage Ratio						
Central Valley Community Bancorp and Subsidiary	$88,320	8.14	%	$90,866	10.56	%
Minimum regulatory requirement	$43,394	4.00	%	$34,418	4.00	%
Central Valley Community Bank	$87,674	8.09	%	$87,911	10.22	%
Minimum requirement for "Well-Capitalized" institution	$54,218	5.00	%	$42,994	5.00	%
Minimum regulatory requirement	$43,375	4.00	%	$34,395	4.00	%
Tier 1 Risk-Based Capital Ratio						
Central Valley Community Bancorp and Subsidiary	$88,320	13.88	%	$90,866	18.24	%
Minimum regulatory requirement	$25,454	4.00	%	$19,926	4.00	%
Central Valley Community Bank	$87,674	13.79	%	$87,911	17.67	%
Minimum requirement for "Well-Capitalized" institution	$38,151	6.00	%	$29,848	6.00	%
Minimum regulatory requirement	$25,434	4.00	%	$19,899	4.00	%
Total Risk-Based Capital Ratio						
Central Valley Community Bancorp and Subsidiary	$96,292	15.13	%	$97,299	19.53	%
Minimum regulatory requirement	$50,908	8.00	%	$39,853	8.00	%
Central Valley Community Bank	$95,639	15.04	%	$94,336	18.96	%
Minimum requirement for "Well-Capitalized" institution	$63,585	10.00	%	$49,747	10.00	%
Minimum regulatory requirement	$50,868	8.00	%	$39,798	8.00	%

We are required to deduct the disallowed portion of net deferred tax assets from Tier 1 capital in calculating our capital ratios. Generally, disallowed deferred tax assets that are dependent upon future taxable income are limited to the lesser of the amount of deferred tax assets that we expect to realize within one year, based on projected future taxable income, or 10% of the amount of our Tier 1 capital. Disallowed deferred tax assets deducted from Tier 1 capital were $7,330,000 and $53,000 at December 31, 2013 and 2012, respectively.

LIQUIDITY

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Liquidity management involves our ability to meet cash flow requirements arising from fluctuations in deposit levels and demands of daily operations, which include funding of securities purchases, providing for customers' credit needs and ongoing repayment of borrowings. Our liquidity is actively managed on a daily basis and reviewed periodically by our management and Director's Asset/Liability Committees. This process is intended to ensure the maintenance of sufficient funds to meet our needs, including adequate cash flows for off-balance sheet commitments.

Our primary sources of liquidity are derived from financing activities which include the acceptance of customer and, to a lesser extent, broker deposits, Federal funds facilities and advances from the Federal Home Loan Bank of San Francisco (FHLB). These funding sources are augmented by payments of principal and interest on loans, the routine maturities and pay downs of securities from the securities portfolio, the stability of our core deposits and the ability to sell investment securities. As of December 31, 2013, the Company had unpledged securities totaling $344,015,000 available as a secondary source of liquidity and total cash and cash equivalents of $112,052,000. Cash and cash equivalents at December 31, 2013 increased 111.59% compared to December 31, 2012. Primary uses of funds include withdrawal of and interest payments on deposits, origination and purchases of loans, purchases of investment securities, and payment of operating expenses. Due to the negative impact of the slow economic recovery, we have been cautiously managing our asset quality. Consequently, expanding our loan portfolio or finding adequate investments to utilize some of our excess liquidity has been difficult in the current economic environment.

As a means of augmenting our liquidity, we have established Federal funds lines with various correspondent banks. At December 31, 2013, our available borrowing capacity includes approximately $40,000,000 in Federal funds lines with our correspondent banks and $272,797,000 in unused FHLB advances. At December 31, 2013, we were not aware of any information that was reasonably likely to have a material effect on our liquidity position. The following table reflects the Company's credit lines, balances outstanding, and pledged collateral at December 31, 2013 and 2012:

Credit Lines (In thousands)	December 31, 2013	December 31, 2012
Unsecured Credit Lines (interest rate varies with market):		
Credit limit	$40,000	$40,000
Balance outstanding	$—	$—
Federal Home Loan Bank (interest rate at prevailing interest rate):		
Credit limit	$272,797	$133,034
Balance outstanding	$—	$4,000
Collateral pledged	$119,539	$94,368
Fair value of collateral	$119,902	$94,809
Federal Reserve Bank (interest rate at prevailing discount interest rate):		
Credit limit	$51	$127
Balance outstanding	$—	$—
Collateral pledged	$48	$115
Fair value of collateral	$52	$129

The liquidity of our parent company, Central Valley Community Bancorp, is primarily dependent on the payment of cash dividends by its subsidiary, Central Valley Community Bank, subject to limitations imposed by regulations.

OFF-BALANCE SHEET ITEMS

In the normal course of business, the Company is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received. The balance of commitments to extend credit on undisbursed construction and other loans and letters of credit was $192,667,000 as of December 31, 2013 compared to $162,851,000 as of December 31, 2012. For a more detailed discussion of these financial instruments, see Note 13 to the audited Consolidated Financial Statements in this Annual Report.

In the ordinary course of business, the Company is party to various operating leases. For a more detailed discussion of these financial instruments, see Note 13 to the audited Consolidated Financial Statements in this Annual Report.

CRITICAL ACCOUNTING POLICIES

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The Securities and Exchange Commission (SEC) has issued disclosure guidance for "critical accounting policies." The SEC defines "critical accounting policies" as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in future periods.

Our accounting policies are integral to understanding the results reported. Our significant accounting policies are described in detail in Note 1 in the audited Consolidated Financial Statements. Not all of the significant accounting policies presented in Note 1 of the audited Consolidated Financial Statements in this Annual Report require management to make difficult, subjective or complex judgments or estimates.

Use of Estimates

The preparation of these financial statements requires management to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses. On an ongoing basis, management evaluates the estimates used. Estimates are based upon historical experience, current economic conditions and other factors that management considers reasonable under the circumstances.

These estimates result in judgments regarding the carrying values of assets and liabilities when these values are not readily available from other sources, as well as assessing and identifying the accounting treatments of contingencies and commitments. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates under different assumptions. The allowance for credit losses, deferred taxes assets and fair values of financial instruments are estimates which are particularly subject to change.

Accounting Principles Generally Accepted in the United States of America

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP).

We follow accounting policies typical to the commercial banking industry and in compliance with various regulation and guidelines as established by the Public Company Accounting Oversight Board (PCAOB), Financial Accounting Standards Board (FASB), the American Institute of Certified Public Accountants (AICPA), and the Bank's primary federal regulator, the FDIC. The following is a brief description of our current accounting policies involving significant management judgments.

Allowance for Credit Losses

Our most significant management accounting estimate is the appropriate level for the allowance for credit losses. The allowance for credit losses is an estimate of probable credit losses inherent in the Company's loan portfolio that have been incurred as of the balance sheet date. The adequacy of the allowance is monitored on an on-going basis and is based on our management's evaluation of numerous factors. These factors include the quality of the current loan portfolio, the trend in the loan portfolio's risk ratings, current economic conditions, loan concentrations, loan growth rates, past-due and nonperforming trends, evaluation of specific loss estimates for all significant problem loans, historical charge-off and recovery experience and other pertinent information. See Note 1 to the audited Consolidated Financial Statements in this Annual Report for more detail regarding our allowance for credit losses.

The calculation of the allowance for credit losses is by nature inexact, as the allowance represents our management's best estimate of the probable losses inherent in our credit portfolios at the reporting date. These credit losses will occur in the future, and as such cannot be determined with absolute certainty at the reporting date.

Impairment of Investment Securities

Investment securities are impaired when the amortized cost exceeds fair value. Investment securities are evaluated for impairment on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Company to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospect for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other-than-temporary and we do not intend to sell the security or it is more likely than not that we will not be required to sell the security before recovery, only the portion of the impairment loss representing credit exposure is recognized as a charge to earnings, with the balance recognized as a charge to other comprehensive income. If management intends to sell the security or it is more likely than not that we will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings.

Amortization of Premiums/Discount Accretion on Investments

We invest in Collateralized Mortgage Obligations (CMO) and Mortgage Backed Securities, (MBS) as part of the overall strategy to increase our net interest margin. CMOs and MBS by their nature react to changes in interest rates. In a normal declining rate environment, prepayments from MBS and CMOs would be expected to increase and the expected life of the investment would be expected to shorten. Conversely, if interest rates increase, prepayments normally would be expected to decline and the average life of the MBS and CMOs would be expected to extend. However, in the current economic environment, prepayments may not behave according to historical norms. Premium amortization and discount accretion of these investments affects our net interest income. Our management monitors the prepayment speed of these investments and adjusts premium amortization and discount accretion based on several factors. These factors include the type of investment, the investment structure, interest rates, interest rates on new mortgage loans, expectation of interest rate changes, current economic conditions, the level of principal remaining on the bond, the bond coupon rate, the bond origination date, and volume of available bonds in market. The calculation of premium amortization and discount accretion is by nature inexact, and represents management's best estimate of principal pay downs inherent in the total investment portfolio.

Goodwill

Business combinations involving the Company's acquisition of the equity interests or net assets of another enterprise or the assumption of net liabilities in an acquisition of branches constituting a business may give rise to goodwill. Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed in transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Company's ability to generate net earnings after the acquisition. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed for impairment at a reporting unit level at least annually or more often if an event occurs or circumstances change that would more likely than not reduce the fair value of the Company below its carrying amount. While the Company believes all assumptions utilized in its assessment of goodwill for impairment are reasonable and appropriate, changes could cause the Company to record impairment in the future.

Share-Based Compensation

The Company recognizes compensation expense in an amount equal to the fair value of all share-based payments which consist of stock options granted to directors and employees. The fair value of each option is estimated on the date of grant and amortized over the service period using a Black-Scholes-Merton based option valuation model that requires the use of assumptions to estimate the grant date fair value. The estimates are based on assumptions on the expected option life, the level of estimated forfeitures, expected stock volatility and the risk-free interest rate. The calculation of the fair value of share based payments is by nature inexact, and represents management's best estimate of the grant date fair value of the share based payments. See Note 15 to the audited Consolidated Financial Statements in this Annual Report.

Accounting for Income Taxes

The Company files its income taxes on a consolidated basis with its subsidiary. The allocation of income tax expense (benefit) represents each entity's proportionate share of the consolidated provision for income taxes.
Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets and liabilities are adjusted for the

effects of changes in tax laws and rates on the date of enactment. On the balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.
The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred income tax assets is assessed and a valuation allowance is recorded if is “more likely than not” that all or a portion of the deferred tax asset will not be realized. “More likely than not” is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed.
Only tax positions that meet the more-likely-than-not recognition threshold are recognized. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the

more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest expense and penalties associated with unrecognized tax benefits are classified as income tax expense in the consolidated statement of income.

INFLATION

The impact of inflation on a financial institution differs significantly from that exerted on other industries primarily because the assets and liabilities of financial institutions consist largely of monetary items. However, financial institutions are affected by inflation in part through non-interest expenses, such as salaries and occupancy expenses, and to some extent by changes in interest rates.

At December 31, 2013, we do not believe that inflation will have a material impact on our consolidated financial position or results of operations. However, if inflation concerns cause short term rates to rise in the near future, we may benefit by immediate repricing of a portion of our loan portfolio. Refer to Market Risk section for further discussion.

ITEM 7A - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest rate risk (IRR) and credit risk constitute the two greatest sources of financial exposure for insured financial institutions that operate like we do. IRR represents the impact that changes in absolute and relative levels of market interest rates may have upon our net interest income (NII). Changes in the NII are the result of changes in the net interest spread between interest-earning assets and interest-bearing liabilities (timing risk), the relationship between various rates (basis risk), and changes in the shape of the yield curve.

We realize income principally from the differential or spread between the interest earned on loans, investments, other interest-earning assets and the interest incurred on deposits and borrowings. The volumes and yields on loans, deposits and borrowings are affected by market interest rates. As of December 31, 2013, 78.41% of our loan portfolio was tied to adjustable-rate indices. The majority of our adjustable rate loans are tied to prime and reprice within 90 days. However, in the current low rate environment, several of our loans, tied to prime, are at their floors and will not reprice until prime plus the factor is greater than the floor. The majority of our time deposits have a fixed rate of interest. As of December 31, 2013, 79.96% of our time deposits matures within one year or less.

Changes in the market level of interest rates directly and immediately affect our interest spread, and therefore profitability. Sharp and significant changes to market rates can cause the interest spread to shrink or expand significantly in the near term, principally because of the timing differences between the adjustable rate loans and the maturities (and therefore repricing) of the deposits and borrowings.

Our management and Board of Directors' Asset/Liability Committees (ALCO) are responsible for managing our assets and liabilities in a manner that balances profitability, IRR and various other risks including liquidity. The ALCO operates under policies and within risk limits prescribed, reviewed, and approved by the Board of Directors.

The ALCO seeks to stabilize our NII by matching rate-sensitive assets and liabilities through maintaining the maturity and repricing of these assets and liabilities at appropriate levels given the interest rate environment. When the amount of rate-sensitive liabilities exceeds rate-sensitive assets within specified time periods, NII generally will be negatively impacted by an increasing interest rate environment and positively impacted by a decreasing interest rate environment. Conversely, when the amount of rate-sensitive assets exceeds the amount of rate-sensitive liabilities within specified time periods, net interest income will generally be positively impacted by an increasing interest rate environment and negatively impacted by a decreasing interest rate environment. In recent years, we have shifted our mix of assets from consisting primarily of loans to a current mix that is approximately half loans and half securities, none of which are held for trading purposes. The value of these securities is subject to interest rate risk, which we must monitor and manage successfully in order to prevent declines in value of these assets if interest rates rise in the future. The speed and velocity of the repricing of assets and liabilities will also contribute to the effects on our NII, as will the presence or absence of periodic and lifetime interest rate caps and floors.

Simulation of earnings is the primary tool used to measure the sensitivity of earnings to interest rate changes. Earnings simulations are produced using a software model that is based on actual cash flows and repricing characteristics for all of our financial instruments and incorporates market-based assumptions regarding the impact of changing interest rates on current volumes of applicable financial instruments.

Interest rate simulations provide us with an estimate of both the dollar amount and percentage change in NII under various rate scenarios. All assets and liabilities are normally subjected to up to 400 basis point increases and decreases in interest rates in 100 basis point increments. Under each interest rate scenario, we project our net interest income. From these results, we can then develop alternatives in dealing with the tolerance thresholds.

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Approximately 78.41% of our loan portfolio is tied to adjustable rate indices and 36.86% of our loan portfolio reprices within 90 days. As of December 31, 2013, we had 988 commercial and real estate loans totaling $266,363,000 with floors ranging from 3.25% to 7.50% and ceilings ranging from 6.50% to 25.00%.
The following table shows the effects of changes in projected net interest income for the twelve months ending December 31, 2014 under the interest rate shock scenarios stated. The table was prepared as of December 31, 2013, using a prime interest rate of 3.25%.

Sensitivity Analysis of Impact of Rate Changes on Interest Income

Hypothetical Change in Rates	Projected Net Interest Income	$ Change from Rates at December 31, 2013	% Change from Rates at December 31, 2013
(Dollars in thousands)			
Up 300 bps	$38,766	$ 4,032	11.61 %
Up 200 bps	37,332	2,598	7.48 %
Up 100 bps	35,863	1,129	3.25 %
Unchanged	34,734	—	—
Down 25 bps	34,121	(613)	(1.76)%

Assumptions are inherently uncertain, and, consequently, the model cannot precisely measure net interest income or precisely predict the impact of changes in interest rates on net interest income. Actual results will differ from simulated results due to timing, magnitude and frequency of interest rate changes, as well as changes in market conditions and management strategies which might moderate the negative consequences of interest rate deviations.

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ITEM 8 - FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Shareholders and Board of Directors
Central Valley Community Bancorp and Subsidiary
Fresno, California

We have audited the accompanying consolidated balance sheets of Central Valley Community Bancorp and subsidiary (the "Company") as of December 31, 2013 and 2012, 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, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. 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 the Company as of December 31, 2013 and 2012, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

/s/ Crowe Horwath LLP

Sacramento, California
March 19, 2014

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CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2013 and 2012
(In thousands, except share amounts)

	2013	2012
ASSETS		
Cash and due from banks	$25,878	$22,405
Interest-earning deposits in other banks	85,956	30,123
Federal funds sold	218	428
Total cash and cash equivalents	112,052	52,956
Available-for-sale investment securities (Amortized cost of $447,108 at December 31, 2013 and $381,074 at December 31, 2012)	443,224	393,965
Loans, less allowance for credit losses of $9,208 at December 31, 2013 and $10,133 at December 31, 2012	503,149	385,185
Bank premises and equipment, net	10,541	6,252
Other real estate owned	190	—
Bank owned life insurance	19,443	12,163
Federal Home Loan Bank stock	4,499	3,850
Goodwill	29,917	23,577
Core deposit intangibles	1,680	583
Accrued interest receivable and other assets	20,940	11,697
Total assets	$1,145,635	$890,228
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Deposits:		
Non-interest bearing	$356,392	$240,169
Interest bearing	647,751	511,263
Total deposits	1,004,143	751,432
Short-term borrowings	—	4,000
Junior subordinated deferrable interest debentures	5,155	5,155
Accrued interest payable and other liabilities	16,294	11,976
Total liabilities	1,025,592	772,563
Commitments and contingencies (Note 13)		
Shareholders’ equity:		
Preferred stock, no par value, $1,000 per share liquidation preference; 10,000,000 shares authorized, Series C, issued and outstanding: none at December 31, 2013 and 7,000 shares at December 31, 2012	—	7,000
Common stock, no par value; 80,000,000 shares authorized; issued and outstanding: 10,914,680 at December 31, 2013 and 9,558,746 at December 31, 2012	53,981	40,583
Retained earnings	68,348	62,496
Accumulated other comprehensive (loss) income, net of tax	(2,286)	7,586
Total shareholders’ equity	120,043	117,665
Total liabilities and shareholders’ equity	$1,145,635	$890,228

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

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CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2013, 2012, and 2011

(In thousands, except per share amounts)	2013	2012	2011
Interest income:			
Interest and fees on loans	$26,519	$23,913	$26,098
Interest on deposits in other banks	164	108	187
Interest on Federal funds sold	—	2	