Oak Valley Bancorp
Form 10-K/A
March 26, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

(Amendment No. 1)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number: 001-34142

OAK VALLEY BANCORP

(Exact name of registrant as specified in its charter)

California (State or other jurisdiction of incorporation or organization)	**26-2326676** (I.R.S. Employer Identification No.)
125 North Third Avenue **Oakdale, California** (Address of principal executive offices)	**95361** (Zip Code)

(209) 848-2265

(Registrant's telephone number including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock	The NASDAQ Stock Market, LLC

Securities registered pursuant to Section 12(g) of the Act: **None**
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

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 No

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 No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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.

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

Large accelerated filer   Accelerated filer   Non-accelerated filer   Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of June 30, 2018, the last business day of the Registrant's most recently completed second fiscal quarter, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant, based upon the closing price of $22.30 per share of the registrant's common stock as reported by the NASDAQ, was approximately $157 million. As of February 26, 2019, there were 8,195,459 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the Annual Meeting of Shareholders will be filed with the Commission within 120 days after the end of the Registrant's 2018 fiscal year end and are incorporated by reference into Part III of this report.

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-K/A (the "Amendment") amends the Annual Report on Form 10-K for the fiscal year ended December 31, 2018 (the "Form 10-K"), which Oak Valley Bancorp (the "Company") originally filed with the Securities and Exchange Commission ("SEC") on March 11, 2019 (the "Original Filing"). This Amendment is being filed solely to amend and replace Item 7 of the Form 10-K to correct an error in the Company's reporting of its book value per common share as of December 31, 2018, which should have been reported as $12.09 instead of $18.30 and to check the box on the cover page indicating that the Company is a "smaller reporting company" as defined in Rule 12b-2 of the Securities Exchange Act of 1934, as amended.

Except as described above, this Amendment does not modify, amend, or update any other disclosures or information presented in the Original Filing, and this Amendment does not reflect events occurring after the filing of the Original Filing. Accordingly, this Amendment should be read in conjunction with the Original Filing.

As required by Rule 12b-15 of the Securities Exchange Act of 1934, as amended, this Amendment contains new certifications by the Company's principal executive officer and principal financial officer, which are being filed as exhibits to the Amendment. Because the Amendment includes no financial statements, the Company is not including certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following discussion of financial condition as of December 31, 2018 and 2017 and results of operations for each of the years in the two-year period ended December 31, 2018 should be read in conjunction with our consolidated financial statements and related notes thereto, included in this report. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances. This discussion contains forward-looking statements that reflect our plans, estimates and beliefs and involve numerous risks and uncertainties. Actual results may differ materially from those contained in any forward-looking statements. You should carefully read "Special Note Regarding Forward-Looking Statements" included in this report.

Introduction

Our continued focus on responsible community banking fundamentals and our strong customer relationships have enabled us to increase our market presence through growth in our loan portfolio, which is primarily funded by steady core deposit growth.

As of December 31, 2018, we had approximately $1.1 billion in total assets, $712 million in total gross loans, and $986 million in total deposits.

We believe the following were key indicators of our performance during 2018:

Total assets increased to $1.09 billion at the end of 2018, an increase of 5.8%, from $1.03 billion at the end of 2017.

Total deposits increased to $986 million at the end of 2018, an increase of 5.1%, from $939 million at the end of 2017.

Total net loans increased to $702 million at the end of 2018, an increase of 7.5%, from $653 million at the end of 2017.

Net interest income increased to $38.6 million in 2018, an increase of $4.4 million or 12.8%, compared to $34.2 million in 2017, mainly as a result of growth of our loan and investment portfolios.

Provision for loan losses increased by $205,000 to $555,000 in 2018, compared to $350,000 in 2017, mainly due to loan growth as overall credit quality remains strong.

The ratio of total non-performing loans to total loans decreased to 0.13% at December 31, 2018 from 0.20% at December 31, 2017. Management considers the size of the ratio of non-performing assets to total loans to be low and manageable, and reserves have been taken appropriately.

Total noninterest income decreased to $4.7 million in 2018, a decrease of 21.2%, from $6.0 million in 2017, which is mainly attributable to merger related settlement payments from professional service providers recorded during 2017.

Total noninterest expense increased from $24.6 million in 2017 to $27.4 million in 2018, primarily due to one new branch that opened in 2018, two branch relocations in 2018, and increased general operating costs to support our growing loan and deposit portfolios.

Provision from income taxes decreased by $2.3 million to $3.8 million in 2018, mainly due to the lower federal income tax rate and the $983,000 deferred tax asset re-measurement recorded in December 2017, following the passing of the U.S. Tax Cuts and Jobs Act of 2017.

These items, as well as other factors, contributed to the increase in net income for 2018 to $11.5 million from $9.09 million in 2017, which translates into $1.42 per diluted share in 2018 as compared to $1.13 per diluted share in 2017.

Over the past several years, our network of branches and loan production offices have expanded geographically. We currently maintain seventeen full-service offices. We intend to continue our growth strategy in future years through the opening of additional branches and loan production offices as our needs and resources permit.

2019 Outlook

As we begin our strategic business plan for 2019, we remained focused on relationship-based expansion throughout our market area. We will continue to focus on increasing our loan-to-deposit ratio to expand our net interest margin, while attempting to control expenses and credit losses.

The increased market interest rates in recent years has had a positive impact on net interest income mainly due to growth of earning assets and the fact that our balance sheet is slightly asset sensitive. We expect that we will likely not realize the same positive impact if there is a pull-back on the level of interest rate increases in 2019. The potential compression of net interest income and net interest margin would be a likely outcome if interest rates remain static or decline, given that our balance sheet is asset sensitive to interest rate changes primarily due to the number of variable rate loans and a high level of interest-earning cash balances. This could in turn result in further decrease on the yield of earning assets compared to the cost of deposits and other funds, which remain at historic lows which cannot reasonably be further reduced.

Favorable trends in our economy prompted the Federal Reserve Open Market Committee, or FOMC, to increase the target federal funds by 0.25% in 2016, 0.75% in 2017 and 1.00% in 2018. Given our asset sensitive balance sheet, our net interest income will be expected to benefit from interest rate increases, but any such benefit will be proportional to the increase in rates. If we experience an increase in our yield on earnings assets, we could then determine to increase the interest rates we pay on our deposit accounts or change our promotional or other interest rates on new deposits in marketing activation programs to attempt to achieve a certain net interest margin. That said, in light of the current economic environment, if the rates increase is modest, it may not be possible to manage the interest margin in this manner, as competitive pressures may dictate that we increase deposit rates at a faster rate than the earning assets increase, thereby offsetting any gains to the net interest margin. The economies and real estate markets in our primary market areas will continue to be significant determinants of the quality of our assets in future periods and, thus, our results of operations, liquidity and financial condition.

For 2019, management remains focused on the above challenges and opportunities and other factors affecting the business similar to the factors driving the 2018 results as discussed in this section.

Critical Accounting Policies

Critical accounting policies are those that are most important to the portrayal of our financial condition and results of operations and require 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.

The discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these financial statements requires management to make estimates and judgments that effect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions. In addition, GAAP itself may change from one previously acceptable method to another method, although the economics of our transactions would be the same.

Management has determined the following accounting policies to be critical:

Asset Impairment Judgments

Certain of our assets are carried in our consolidated balance sheets at fair value or at the lower of cost or fair value. Valuation allowances are established when necessary to recognize impairment of such assets. We periodically perform analyses to test for impairment of various assets. In addition to our impairment analyses related to loans, another significant impairment analysis relates to other than temporary declines in the value of our securities.

Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired and are carried at fair value or below. Appraisals are done periodically on impaired loans and if required, an allowance is established based on the fair value of collateral less the cost related to liquidation of the collateral. In some circumstances, an impaired loan may be charged off to bring the carrying value to fair value.

Other real estate assets ("OREO") acquired through, or in lieu of, foreclosure, are held-for-sale and are initially recorded at the lower of cost or fair value, less selling costs. Any write-downs to fair value at the time of transfer to OREO are charged to the allowance for loan losses, subsequent to foreclosure. Appraisals or evaluations are then done periodically thereafter, charging any additional write-downs or valuation allowances to the appropriate expense accounts.

Net realizable value of the underlying collateral is the fair value of the collateral, less estimated selling costs and any prior liens. Appraisals, recent comparable sales, offers and listing prices are factored in when valuing the collateral. We review and verify the qualifications and licenses of the certified general appraisers used for appraising commercial properties or certified residential appraisers for residential properties. Real estate appraisals may utilize a combination of approaches including replacement cost, sales comparison and the income approach. Comparable sales and income data are analyzed by the appraisers and adjusted to reflect differences between them and the subject property such as type, leasing status and physical condition. When the appraisals are received, management reviews the assumptions and methodology utilized in the appraisal, as well as the overall resulting value in conjunction with independent data sources, such as recent market data and industry-wide statistics. We generally use a 6% discount for selling costs which is applied to all properties, regardless of size. Appraised values may be adjusted to reflect changes in market conditions that have occurred subsequent to the appraisal date, or for revised estimates regarding the timing or cost of the property sale. These adjustments are based on qualitative judgments made by management on a case-by-case basis.

Our available for sale portfolio is carried at estimated fair value, with any unrealized gains and losses, net of taxes, reported as accumulated other comprehensive income in shareholders' equity. We conduct a periodic review and evaluation of the securities portfolio to determine if the value of any security has declined below its carrying value and whether such decline is other than temporary. If such decline is deemed other than temporary, we would adjust the carrying amount of the security by writing down the security to fair value through a charge to current period income. The fair values of our securities are significantly affected by changes in interest rates.

In general, as interest rates rise, the fair value of fixed-rate securities will decrease; as interest rates fall, the fair value of fixed-rate securities will increase. With significant changes in interest rates, we evaluate our intent and ability to hold the security for a sufficient time to recover the recorded principal balance. Estimated fair values for securities are based on published or securities dealers' market values. Market volatility is unpredictable and may impact such values.

Allowance for Loan Losses

Credit risk is inherent in the business of lending and making commercial loans. Accounting for our allowance for loan losses involves significant judgment and assumptions by management and is based on historical data and management's view of the current economic environment. At least on a quarterly basis, our management reviews the methodology and adequacy of allowance for loan losses and reports its assessment to the Board of Directors for its review and approval.

The allowance for loan losses is an estimate of probable incurred losses with regard to our loans. Our loan loss provision for each period is dependent upon many factors, including loan growth, net charge-offs, changes in the composition of the loans, delinquencies, management's assessment of the quality of the loans, the valuation of problem loans and the general economic conditions in our market area. We base our allowance for loan losses on an estimation of probable losses inherent in our loan portfolio.

Our methodology for assessing loan loss allowances are intended to reduce the differences between estimated and actual losses and involves a detailed analysis of our loan portfolio, in three phases:

the specific review of individual loans,

the segmenting and review of loan pools with similar characteristics, and

our judgmental estimate based on various subjective factors:

The first phase of our methodology involves the specific review of individual loans to identify and measure impairment. We evaluate each loan by use of a risk rating system, except for homogeneous loans, such as automobile loans and home mortgages. Specific risk rated loans are deemed impaired if all amounts, including principal and interest, will likely not be collected in accordance with the contractual terms of the related loan agreement. Impairment for commercial and real estate loans is measured either based on the present value of the loan’s expected future cash flows or, if collection on the loan is collateral dependent, the estimated fair value of the collateral, less selling and holding costs.

The second phase involves the segmenting of the remainder of the risk rated loan portfolio into groups or pools of loans, together with loans with similar characteristics, for evaluation. We determine the calculated loss ratio to each loan pool based on its historical net losses and benchmark it against the levels of other peer banks.

In the third phase, we consider relevant internal and external factors that may affect the collectability of loan portfolio and each group of loan pool. The factors considered are, but are not limited to:

- concentration of credits,
- nature and volume of the loan portfolio,
- delinquency trends,
- non-accrual loan trend,
- problem loan trend,
- loss and recovery trend,
- quality of loan review,
- lending and management staff,
- lending policies and procedures,
- economic and business conditions, and
- other external factors.

Our management estimates the probable effect of such conditions based on our judgment, experience and known or anticipated trends. Such estimation may be reflected as an additional allowance to each group of loans, if necessary. Management reviews these conditions with our senior credit officers. To the extent that any of these conditions is evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management’s estimate of the effect of such condition may be reflected as a specific allowance applicable to such credit or portfolio segment. Where any of these conditions is not evidenced by a specific, identifiable problem credit or portfolio segment as of the evaluation date, management’s evaluation of the inherent loss related to such condition is reflected in the unallocated allowance.

Central to our credit risk management and our assessment of appropriate loss allowance is our loan risk rating system. Under this system, the originating credit officer assigns borrowers an initial risk rating based on a thorough analysis of each borrower's financial capacity in conjunction with industry and economic trends. Approvals are made based upon the amount of inherent credit risk specific to the transaction and are reviewed for appropriateness by senior line and credit administration personnel. Credits are monitored by line and credit administration personnel for deterioration in a borrower's financial condition which may impact the ability of the borrower to perform under the contract. Although management has allocated a portion of the allowance to specific loans, specific loan pools, and off-balance sheet credit exposures (which are reported separately as part of other liabilities), the adequacy of the allowance is considered in its entirety.

It is the policy of management to maintain the allowance for loan losses at a level adequate for risks inherent in the overall loan portfolio, however, the loan portfolio can be adversely affected if the state of California's economic conditions and its real estate market in our general market area were to further deteriorate or weaken. Additionally, further weakness of a prolonged nature in the agricultural and general economy would have a negative impact on the local market. The effect of such economic events, although uncertain and unpredictable at this time, could result in an increase in the levels of nonperforming loans and additional loan losses, which could adversely affect our future growth and profitability. No assurance of the level of predicted credit losses can be given with any certainty.

Non-Accrual Loan Policy

Interest on loans is credited to income as earned and is accrued only if deemed collectible. Accrual of interest is discontinued when a loan is over 90 days delinquent or if management believes that collection is highly uncertain. Generally, payments received on nonaccrual loans are recorded as principal reductions. Interest income is recognized after all principal has been repaid or an improvement in the condition of the loan has occurred that would warrant resumption of interest accruals.

Income Taxes

Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company’s assets and liabilities. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled using the liability method. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

The Company files income tax returns in the U.S. federal jurisdiction, and the state of California. With few exceptions, the Company is no longer subject to U.S. federal or state/local income tax examinations by tax authorities for years before 2014.

Fair Value Measurements

We use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. We base our fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Securities available for sale, derivatives, and loans held for sale, if any, are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record certain assets at fair value on a non-recurring basis, such as certain impaired loans held for investment and securities held to maturity that are other-than-temporarily impaired. These non-recurring fair value adjustments typically involve write-downs of individual assets due to application of lower-of-cost or market accounting.

We have established and documented a process for determining fair value. We maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. Whenever there is no readily available market data, management uses its best estimate and assumptions in determining fair value, but these estimates involve inherent uncertainties and the application of management's judgment. As a result, if other assumptions had been used, our recorded earnings or disclosures could have been materially different from those reflected in these financial statements. For detailed information on our use of fair value measurements and our related valuation methodologies, see Note 15 to the Consolidated Financial Statements in Item 8 of this report.

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606). This ASU is a converged standard involving FASB and International Financial Reporting Standards that provides a single comprehensive revenue recognition model for all contracts with customers across transactions and industries. The core principal of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount and at a time that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Subsequent updates related to Revenue from Contracts with Customers (Topic 606) are as follows:

August 2015 ASU No. 2015-14 - Deferral of the Effective Date, institutes a one-year deferral of the effective date of this amendment to annual reporting periods beginning after December 15, 2017. Early application is permitted only as of annual periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

March 2016 ASU No. 2016-08 - Principal versus Agent Considerations (Reporting Revenue Gross versus Net), clarifies the implementation guidance on principal versus agent considerations and on the use of indicators that assist an entity in determining whether it controls a specified good or service before it is transferred to the customer.

April 2016 ASU No. 2016-10 - Identifying Performance Obligations and Licensing, provides guidance in determining performance obligations in a contract with a customer and clarifies whether a promise to grant a license provides a right to access or the right to use intellectual property.

May 2016 ASU No. 2016-12 - Narrow Scope Improvements and Practical Expedients, gives further guidance on assessing collectability, presentation of sales taxes, noncash consideration, and completed contracts and contract modifications at transition.

Topic 606 was adopted by the Company on January 1, 2018 and did not have a material impact on the Company's consolidated financial statements. No additional disaggregated revenue disclosures are necessary because interest income sources are scoped out and there are no additional significant noninterest income sources to break out on the consolidated statement of income.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments - Overall (Subtopic 825-10)*: Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in this ASU make improvements to GAAP related to financial instruments that include the following as applicable to us.

Equity investments, except for those accounted for under the equity method of accounting or those that result in consolidation of the investee, are required to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for an identical or a similar investment of the same issuer.

This ASU simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment - if impairment exists, this requires measuring the investment at fair value.

This ASU eliminates the requirement for public companies to disclose the method(s) and significant assumptions used to estimate the fair value that is currently required to be disclosed for financial instruments measured at amortized cost on the balance sheet.

Public companies will be required to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes.

This ASU requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements.

The reporting entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

ASU 2016-01 is effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. This ASU was adopted by the Company on January 1, 2018 and impacted the Company’s financial statement disclosures but did not have a material impact on the Company’s financial condition or results of operations.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842).* This ASU was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities, including leases classified as operating leases under previous GAAP, on the balance sheet and requiring additional disclosures of key information about leasing arrangements. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, including interim periods within those annual periods, and requires a modified retrospective approach to adoption. Early application of the ASU is permitted. The Company has evaluated the impact to its balance sheet and expects that the gross-up in its balance sheet from recording a right-of-use asset and a lease liability for each lease as a result of adopting this ASU will not be material.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326).* This update changes the methodology used by financial institutions under current U.S. GAAP to recognize credit losses in the financial statements. Currently, U.S. GAAP requires the use of the incurred loss model, whereby financial institutions recognize in current period earnings, incurred credit losses and those inherent in the financial statements, as of the date of the balance sheet. This guidance results in a new model for estimating the allowance for loan and lease losses, commonly referred to as the Current Expected Credit Loss ("CECL") model. Under the CECL model, financial institutions are required to estimate future credit losses and recognize those losses in current period earnings. The amendments within the update are effective for fiscal years and all interim periods beginning after December 15, 2019, with early adoption permitted. Upon adoption of the amendments within this update, the Company will be required to make a cumulative-effect adjustment to the opening balance of retained earnings in the year of adoption. The Company is currently in the process of evaluating the impact the adoption of this update will have on its financial statements. While the Company has not quantified the impact of this ASU, it does expect changing from the current incurred loss model to an expected loss model will result in an earlier recognition of losses.

In February 2018, the FASB issued ASU 2018-02, *Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The ASU was issued to address certain stranded tax effects in accumulated other comprehensive income as a result of the Tax Cuts and Jobs Act of 2017. The ASU provides companies the option to reclassify stranded tax effects within accumulated other comprehensive income to retained earnings in each period in which the effect of the change from the newly enacted corporate tax rate is recorded. The amount of the reclassification would be calculated on the basis of the difference between the historical and newly enacted tax rates for deferred tax liabilities and assets related to items within accumulated other comprehensive income. The ASU requires companies to disclose its accounting policy related to releasing income tax effects from accumulated other comprehensive income, whether it has elected to reclassify the stranded tax effects, and information about the other income tax effects that are reclassified. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods, therein, and early adoption is permitted for public business entities for which financial statements have not yet been issued. As of December 31, 2017, the Company adopted the ASU and made a reclassification adjustment from accumulated other comprehensive income to retained earnings on the Consolidated Statements of Shareholders' Equity, related to the stranded tax effects due to the change in the federal corporate tax rate applied on the unrealized gains (losses) on investments on a portfolio basis, to reflect the provisions of this ASU.

Results of Operations

The Company earns income from two primary sources. The first is net interest income, which is interest income generated by earning assets less interest expense on interest-bearing liabilities. The second is noninterest income, which primarily consists of deposit service charges and fees, the increase in cash surrender value of life insurance and mortgage commissions. The majority of the Company's noninterest expenses are operating costs that relate to providing a full range of banking services to our customers.

Overview

We recorded net income for the year ended December 31, 2018 of $11,537,000 or $1.42 per diluted share compared to $9,094,000 or $1.13 per diluted share for the year ended December 31, 2017. The increase in net income for the year ended December 31, 2018 was primarily due to an increase of $4,388,000 in net interest income, mainly from the growth of our loan and investment portfolios. Non-interest income decreased by $1,264,000 in 2018, mainly as a result of non-recurring merger related settlement payments recorded in 2017. The provision for loan losses increased by $205,000 in 2018 due to loan growth. Non-interest expense increased by $2,813,000 associated with two branch relocations and one de novo branch opened in 2018, in addition to general operating overhead increases to support the growth of our loan and deposit portfolios. The income tax provision decreased by $2,337,000 due to the lower federal income tax rate in 2018 and a $983,000 deferred tax asset adjustment in 2017 related to the *U.S. Tax Cuts and Jobs*

Act of 2017.

Highlights of the financial results are presented in the following table:

(Dollars in thousands, except per share data)	**As of and for the years ended December 31, 2018**	**2017**	**2016**
For the period:			
Net income available to common shareholders	$11,537	9,094	$7,665
Net income per common share:			
Basic	$1.43	1.13	$0.95
Diluted	$1.42	1.13	$0.95
Return on average common equity	12.26 %	10.41 %	9.43 %
Return on average assets	1.08 %	0.91 %	0.83 %
Common stock dividend payout ratio of earnings during the period	18.31 %	22.23 %	25.31 %
Efficiency ratio	61.37 %	60.66 %	63.13 %
At period end:			
Book value per common share	$12.09	11.21	$10.19
Total assets	$1,094,887	1,034,852	$1,002,110
Total gross loans	$711,902	662,544	$610,949
Total deposits	$986,495	938,882	$914,093
Net loan-to-deposit ratio	71.18 %	69.55 %	65.76 %

Net Interest Income and Net Interest Margin

Our primary source of revenue is net interest income, which is the difference between interest and fees derived from earning assets and interest paid on liabilities obtained to fund those assets. Our net interest income is affected by changes in the level and mix of interest-earning assets and interest- bearing liabilities, referred to as volume changes. Our net interest income is also affected by changes in the yields earned on assets and rates paid on liabilities, referred to as rate changes. Interest rates charged on our loans are affected principally by the demand for such loans, the supply of money available for lending purposes and competitive factors. Those factors are, in turn, affected by general economic conditions and other factors beyond our control, such as federal economic policies, the general supply of money in the economy, legislative tax policies, governmental budgetary matters, and the actions of the Federal Reserve Board.

For a detailed analysis of interest income and interest expense, see the “Average Balance Sheets” and the “Rate/Volume Analysis” below.

Distribution, Yield and Rate Analysis of Net Income
For the Years Ended December 31,

(Dollars in Thousands)	**2018** Average Balance	Interest Income/ Expense	Avg Rate/ Yield	**2017** Average Balance	Interest Income/ Expense	Avg Rate/ Yield
Assets:						
Earning assets:						
Gross loans (1) (2)	$657,896	$31,777	4.83 %	$624,447	$29,227	4.68 %
Securities of U.S. government agencies	17,933	210	1.17 %	15,289	196	1.28 %
Other investment securities (2)	184,588	6,033	3.27 %	156,310	5,410	3.46 %
Federal funds sold	10,173	191	1.88 %	8,997	100	1.11 %
Interest-earning deposits	137,590	2,646	1.92 %	134,411	1,513	1.13 %
Total interest-earning assets	1,008,180	40,857	4.05 %	939,454	36,446	3.88 %
Total noninterest earning assets	59,303			62,460		
Total Assets	$1,067,483			$1,001,914		
Liabilities and Shareholders' Equity:						
Interest-bearing liabilities:						
Interest-Earning DDA	238,829	517	0.22 %	200,942	292	0.15 %
Money market deposits	288,454	913	0.32 %	289,155	553	0.19 %
Savings deposits	74,317	35	0.05 %	69,348	51	0.07 %
Time certificates over $250,000	18,725	68	0.36 %	20,273	74	0.37 %
Other time deposits	26,845	73	0.27 %	31,877	95	0.30 %
Total interest-bearing liabilities	647,170	1,606	0.25 %	611,595	1,065	0.17 %
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	320,810			297,364		
Other liabilities	5,385			5,566		
Total noninterest-bearing liabilities	326,195			302,930		
Shareholders' equity	94,118			87,389		
Total liabilities and shareholders' equity	$1,067,483			$1,001,914		
Net interest income		$39,251			$35,381	
Net interest spread (3)			3.80 %			3.71 %
Net interest margin (4)			3.89 %			3.77 %

(1) Loan fees have been included in the calculation of interest income.

(2) Yields on municipal securities and loans have been adjusted to their fully-taxable equivalents (FTE), based on a federal marginal tax rate of 21.0% in 2018 and 34% in 2017.

(3)

Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

(4) Represents net interest income as a percentage of average interest-earning assets.

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Net interest income, on a fully tax equivalent basis ("FTE"), increased $3,870,000 or 10.9% to $39,251,000 for the year ended December 31, 2018, compared to $35,381,000 in 2017. Net interest spread and net interest margin were 3.80% and 3.89%, respectively, for the year ended December 31, 2018, compared to 3.71% and 3.77%, respectively, for the year ended December 31, 2017. This upward trend is mainly due to the increase in earning asset yield as described below.

Our earning asset yield increased 17 basis points in 2018 compared to 2017. The yield on loans recognized an increase of 15 basis points for 2018 compared to 2017, which was primarily due to loan repricing of variable rate loans, higher rate indexes on new loans and an increase in loan fees. The increase in loan yield was complemented by growth in the loan and investment portfolio average balances of $33,449,000 and $30,922,000, respectively, in 2018 as compared to 2017. Lastly, the recent Federal Reserve interest rate hikes have had a positive impact to our earning asset yield given the large interest-earning cash balances we hold.

The cost of funds on interest-bearing liabilities increased slightly to 0.25% in 2018 compared to 0.17% in 2017 as our excess liquidity has allowed us to keep deposit rates low on a relative basis. Average non-interest-bearing demand deposit balances increased by $23,446,000 in 2018 compared to 2017, which contributed in maintaining our low cost of funds.

In spite of the interest margin expansion the Company has recognized over recent years, there are certain factors that have limited net interest margin expansion and could possibly result in in net interest margin compression if rates were to fall, which include: 1) deposit interest rates remain at historic lows from which they cannot reasonably be further reduced, 2) competition in the lending market restrict significant increases in new loan rates, and 3) deposit growth has out-paced loan growth in recent years resulting in higher interest-bearing cash balances, which yielded approximately 1.92% on average during 2018.

Changes in volume resulted in an increase in net interest income (on a FTE basis) of $2,591,000 for the year of 2018 compared to the year 2017, and changes in interest rates and the mix resulted in an increase in net interest income (on a FTE basis) of $1,279,000 for the year 2018 versus the year 2017. Management closely monitors both total net interest income and the net interest margin.

Market rates are in part based on the FOMC target Federal funds interest rate (the interest rate banks charge each other for short-term borrowings). The change in the Federal funds sold rates is the result of target rate changes implemented by the FOMC. In 2008, there were seven downward adjustments to the target rate totaling 325 basis points, bringing the target interest rate to a historic low with a range of 0% to 0.25% where it remained until December 2015 when the FOMC increased by 0.25% to a range of 0.25% to 0.50%. The FOMC increased the Federal funds rate again in December 2016 by 0.25% to a range of 0.50% to 0.75%. In 2017, the FOMC increased the Federal funds rate by 0.25% on three occasions resulting in a range of 1.25% to 1.50% as of December 31, 2017. In 2018, the FOMC increased the Federal funds rate by 0.25% on four occasions resulting in a range of 2.25% to 2.50% as of

December 31, 2018.

Rate/Volume Analysis

The following table below sets forth certain information regarding changes in interest income and interest expense of the Company for the periods indicated. For each category of earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (change in average volume multiplied by old rate); and (ii) changes in rates (change in rate multiplied by old average volume). Changes in rate/volume (change in rate multiplied by the change in volume) have been allocated to the changes due to volume and rate in proportion to the absolute value of the changes due to volume and rate prior to the allocation.

(Dollars in Thousands)	**For the Year Ended December 31, 2018 vs. 2017 Increases (Decreases) Due to Change In**			**For the Year Ended December 31, 2017 vs. 2016 Increases (Decreases) Due to Change In**		
	Volume	**Rate**	**Total**	**Volume**	**Rate**	**Total**
Interest income:						
Net loans (1)	$1,566	$984	$2,550	$2,191	$(446)	$1,745
Securities of U.S. government agencies	34	(20)	14	104	16	120
Other Investment securities	979	(356)	623	591	(252)	339
Federal funds sold	13	78	91	10	55	65
Interest-earning deposits	36	1,097	1,133	62	784	846
Total interest income	2,628	1,783	4,411	2,958	157	3,115
Interest expense:						
Interest-Earning DDA	$55	$170	$225	$26	$105	$131
Money market deposits	(1)	361	360	2	235	237
Savings deposits	4	(20)	(16)	(8)	(58)	(66)
Time certificates over $250,000	(6)	0	(6)	2	9	11
Other time deposits	(15)	(7)	(22)	(5)	(7)	(12)
Total interest expense	37	504	541	17	284	301
Change in net interest income	$2,591	$1,279	$3,870	$2,941	$(127)	$2,814

(1) Loan fees have been included in the calculation of interest income.

Provision for Loan Losses

Credit risk is inherent in the business of making loans. The Company establishes an allowance for loan losses through charges to earnings, which are shown in the consolidated statements of income as the provision for loan losses. Specifically identifiable and quantifiable losses are promptly charged off against the allowance. The Company maintains the allowance for loan losses at a level that it considers to be adequate to provide for credit losses inherent in its loan portfolio. Management determines the level of the allowance by performing a quarterly analysis that considers concentrations of credit, past loss experience, current economic conditions, the amount and composition of the loan portfolio (including nonperforming and potential problem loans), estimated fair value of underlying collateral, and other information relevant to assessing the risk of loss inherent in the loan portfolio such as loan growth, net charge-offs, changes in the composition of the loan portfolio, and delinquencies. As a result of management's analysis, a range of the potential amount of the allowance for loan losses is determined.

The Company recorded a provision for loan losses of $555,000 during the year ended December 31, 2018 mainly to provide an adequate loan loss reserve for the new loan funding, as compared to provisions of $350,000 for the year ended December 31, 2017. Nonperforming loans were $920,000 at December 31, 2018 and $1,311,000 at December 31, 2017, or 0.13% and 0.20%, respectively, of total loans. Nonperforming loans are primarily in nonperforming real estate construction and development loans. The allowance for loan losses was $8,685,000 and $8,166,000 at December 31, 2018 and 2017, or 1.22% and 1.23%, respectively, of total loans. The decrease in the allowance for loan losses as a percentage of total loans is due to the decrease in non-accrual loans and noted trends in improved credit quality. The continued credit quality improvement has resulted in relatively low net charge-off totals of $36,000 in 2018 and $16,000 in 2017.

The Company will continue to monitor the adequacy of the allowance for loan losses and make additions to the allowance in accordance with the analysis referred to above. Because of uncertainties inherent in estimating the appropriate level of the allowance for loan losses, actual results may differ from management's estimate of credit losses and the related allowance.

Noninterest Income

The following table sets forth a summary of noninterest income for the periods indicated:

	For the Years Ended December 31,			
(Dollars in thousands)	2018		2017	
	(Amount)	(%)	(Amount)	(%)
Service charges on deposit accounts	$1,549	32.9 %	$1,424	23.8 %
Debit card transaction fee income	1,185	25.1 %	1,104	18.5 %
Earnings on cash surrender value of life insurance	511	10.8 %	514	8.6 %
Mortgage commissions	110	2.3 %	168	2.8 %
Gains on called/sold securities	81	1.7 %	395	6.6 %
Gain on sale of OREO	193	4.1 %	211	3.5 %
Other income	1,083	23.0 %	2,160	36.1 %
Total	$4,712	100.0%	$5,976	100.0%
Average assets	$1,067,483		$1,001,914	
Noninterest income as a % of average assets		0.4 %		0.6 %

Noninterest income was $4,712,000 for the year ended December 31, 2018, compared to $5,976,000 for the year 2017. Service charge income and debit card transaction fee income increased to $1,549,000 and $1,185,000, respectively, for the year 2018 compared to $1,424,000 and $1,104,000 for the year 2017, as a result of the increase in the aggregate number of transaction deposit accounts and corresponding service fee income. Earnings on cash surrender value of life insurance and gains recognized a decrease of $3,000 in 2018 compared to 2017, due to a slight yield variance. Mortgage commissions have decreased by $58,000 for the year 2018, as compared to 2017, as a result of the decreased demand for home purchases and refinancing. Gains on called and sold securities decreased from $395,000 in 2017 to $81,000 in 2018, mainly from one security that was called during the first quarter of 2017. There was one sale of an OREO property in 2017 and 2018, which resulted in a gain of $193,000 for 2018 as compared to $211,000 for 2017. In 2018, other income decreased by $1,077,000, which was attributable to merger related settlement payments of $938,000 from professional service providers, and a $108,000 gain on sale of a fixed asset property that was recorded in 2017. The Company continues to evaluate its deposit product offerings with the intention of continuing to expand its offerings to the consumer and business depositors.

Noninterest Expense

The following table sets forth a summary of noninterest expenses for the periods indicated:

(Dollars in thousands)	**For the Years Ended December 31,**			
	2018		**2017**	
	(Amount)	**(%)**	**(Amount)**	**(%)**
Salaries and employee benefits	$16,287	59.5 %	$14,110	57.4 %
Occupancy expenses	3,631	13.3 %	3,346	13.6 %
Data processing fees	1,707	6.2 %	1,560	6.4 %
Regulatory assessments (FDIC & DBO)	440	1.6 %	492	2.0 %
Other operating expenses	5,313	19.4 %	5,057	20.6 %
Total	$27,378	100.0%	$24,565	100.0%
Average assets	$1,067,483		$1,001,914	
Noninterest expenses as a % of average assets		2.6 %		2.5 %

Noninterest expense was $27,378,000 for the year ended December 31, 2018, an increase of $2,813,000 or 11.5% compared to $24,565,000 for the year ended 2017. Salaries and employee benefits increased by $2,177,000 in 2018 to $16,287,000 compared to the prior year. Due to the new Sacramento branch and to support loan and deposit growth, we increased our full-time equivalent staff by eleven as of December 31, 2018 compared to last year, which resulted in increased salary expense and group medical insurance benefits.

Occupancy expense realized an increase of $285,000 in 2018 compared to the prior year, primarily from rent and other overhead expenses. The 2018 total includes rent from the new Sacramento branch and a non-recurring charge of $85,000 for the remaining lease obligation on our vacated Turlock branch, which was relocated during the second quarter of 2018.

Data processing costs increased in 2018 over 2017 by $147,000, primarily due to servicing costs on the growing number of loan and deposit accounts. Other operating expenses increased in 2018 by $256,000 compared to 2017, due to various operating expense increases that were necessary to support the growing loan and deposit portfolios.

FDIC and DBO regulatory assessments decreased by $52,000 to $440,000 in 2018 compared to $492,000 in 2017. The initial base assessment rate for financial institutions varies based on the overall risk profile of the institution as defined by the FDIC and our risk profile was stable during 2017 and 2018, with a slight improvement for both years in asset quality metrics that are included in the risk profile. The result was a reduction in our assessment rate in 2018; however, we expect this will be offset by deposit growth in 2019. The decrease to our recorded expense in 2018 was despite the higher deposit balances in 2018, as the FDIC assessment rates are applied to average quarterly total liabilities as the primary basis.

Other operating expenses increased by $256,000 or 5.1% to $5,313,000 in 2018, primarily as a result of various general operating expense increases required to support our growing business portfolios and compliance mandates, some of which included telephone and data communications, provision for losses on undisbursed loan commitments, audit expenses and director expenses.

Management anticipates that noninterest expense will continue to increase as we continue to grow, and management believes the Company’s administration as currently set up is scalable to handle future deposit growth. However, management remains committed to cost-control and efficiency, and we expect to keep these increases to a minimum relative to growth.

Provision for Income Taxes

We reported a provision for income taxes of $3,810,000 and $6,147,000 for the years 2018 and 2017, respectively. The effective income tax rate on income from continuing operations was 24.8% for the year ended December 31, 2018 compared to 40.3% for the year 2017. Included in the 2017 tax provision is the deferred tax asset re-measurement adjustment of $983,000 related to the *U.S. Tax Cut and Jobs Act of 2017,* which lowered the corporate federal income tax rate to 21% for the 2018 tax year. Excluding this adjustment, the effective tax rate on core operations would have been 33.9% in 2017. These provisions reflect accruals for taxes at the applicable rates for federal income tax and California franchise tax based upon reported pre-tax income and adjusted for the effects of all permanent differences between income for tax and financial reporting purposes (such as earnings on qualified municipal securities, BOLI and certain tax-exempt loans).

Financial Condition

The Company's total assets were $1,094,887,000 at December 31, 2018 compared to $1,034,852,000 at December 31, 2017, an increase of $60,077,000 or 5.8%. Net loans increased $49,231,000, investments increased $27,458,000, bank premises and equipment increased $459,000, interest receivable and other assets increased $5,813,000, while cash and cash equivalents decreased $23,028,000 for the year ended December 31, 2018 as compared to December 31, 2017.

Loans gross of the allowance for loan losses and deferred fees were $711,902,000 at December 31, 2018, compared to $662,544,000 at December 31, 2017, an increase of $49,358,000 or 7.5%. The increase was primarily due to an increase of $37,369,000 or 7.2% in commercial real estate loans, an increase of $12,642,000 or 18.2% in commercial and industrial loans, a decrease of $795,000 or 2.1% in consumer loans and consumer residential loans and an increase of $142,000 or 0.4% in agriculture loans. The composition of the loan portfolio categories remained relatively unchanged as a percentage of total loans, with commercial real estate comprising 78% of the loan portfolio at December 31, 2018 and 2017.

Deposits increased $47,613,000 or 5.1% to $986,495,000 at December 31, 2018 compared to $938,882,000 at December 31, 2017. Money Market and Time Deposits decreased by $7,576,000 and $7,215,000, respectively, while Demand and Savings increased by $55,119,000 and $7,285,000, respectively, as of December 31, 2018 as compared to December 31, 2017.

There were no short-term borrowing or long-term debt outstanding balances at December 31, 2018 and 2017. The Company uses short-term borrowings, primarily short-term FHLB advances, to fund short-term liquidity needs and manage net interest margin.

Equity increased $8,271,000 or 9.1% to $99,038,000 at December 31, 2018, compared to $90,767,000 at December 31, 2017.

Investment Activities

Investments are a key source of interest income. Management of our investment portfolio is set in accordance with strategies developed and overseen by our Investment Committee. Investment balances, including cash equivalents and interest-bearing deposits in other financial institutions, are subject to change over time based on our asset/liability funding needs and interest rate risk management objectives. Our liquidity levels take into consideration anticipated future cash flows and all available sources of credits and are maintained at levels management believes are appropriate to assure future flexibility in meeting anticipated funding needs.

Cash Equivalents and Interest-bearing Deposits in other Financial Institutions

The Company holds federal funds sold, unpledged available-for-sale securities and salable government guaranteed loans to help meet liquidity requirements and provide temporary holdings until the funds can be otherwise deployed or invested. As of December 31, 2018, and 2017, we had $9,720,000 and $6,205,000, respectively, in federal funds sold.

Investment Securities

Management of our investment securities portfolio focuses on providing an adequate level of liquidity and establishing an interest rate-sensitive position, while earning an adequate level of investment income without taking undue risk. Investment securities that we intend to hold until maturity are classified as held-to-maturity securities, and all other investment securities are classified as either available-for-sale or equity securities. Currently, all of our investment securities are classified as available-for-sale, except for one mutual fund classified as an equity security.

The fair value of the equity security was $3,106,000 and $3,112,000 at December 31, 2018 and December 31, 2017, respectively. Consistent with ASU 2016-01, equity securities are carried at fair value with the changes in fair value recognized in the consolidated statement of income. Accordingly, the Company recognized an unrealized loss of $90,000 during the year ended December 31, 2018.

Our available for sale investment securities holdings increased by $27,464,000 or 15.3%, to $206,712,000 at December 31, 2018, compared to holdings of $179,248,000 at December 31, 2017. The carrying values of available-for-sale investment securities are adjusted for unrealized gains or losses as a valuation allowance and any gain or loss is reported on an after-tax basis as a component of other comprehensive income.

Total investment securities as a percentage of total assets increased to 19.2% as of December 31, 2018 compared to 17.6% at December 31, 2017. As of December 31, 2018, $118,771,000 of the investment securities were pledged to secure public deposits.

As of December 31, 2018, the total unrealized loss on debt securities that were in a loss position for less than 12 continuous months was $765,000 with an aggregate fair value of $62,617,000. The total unrealized loss on debt securities that were in a loss position for greater than 12 continuous months was $1,586,000 with an aggregate fair value of $57,672,000.

The following table summarizes the book value and fair value and distribution of our debt investment securities, which does not include equity securities, as of the dates indicated:

Debt Investment Securities Portfolio

	December 31, 2018		**December 31, 2017**		**December 31, 2016**	
Dollars in Thousands	**Amortized Cost**	**Market Value**	**Amortized Cost**	**Market Value**	**Amortized Cost**	**Market Value**
Available-for-Sale:						
U.S. agencies	$44,474	$44,106	$29,741	$29,972	$27,879	$28,286
Collateralized mortgage obligations	2,071	2,012	2,628	2,593	4,159	4,109
Municipal securities	92,257	93,237	91,201	93,067	77,957	78,329
SBA pools	8,707	8,673	11,818	11,850	7,219	7,168
Corporate debt	21,426	20,587	19,358	18,789	21,349	20,563
Asset backed securities	38,395	38,097	22,866	22,977	18,888	18,819
Total debt securities	$207,330	$206,712	$177,612	$179,248	$157,451	$157,274

At December 31, 2018, thirty-four municipalities, eleven U.S. agencies, nine corporate debts, four Small Business Administration pools, three collateralized mortgage obligations and two asset-backed securities make up the total debt securities in an unrealized loss position for greater than 12 months. At December 31, 2018, eighteen U.S. agencies, fourteen municipalities, twelve asset-backed securities, three SBA pools, two corporate debts, one collateralized mortgage obligation make up the total debt securities in a loss position for less than 12 months. Management periodically evaluates each available-for-sale investment security in an unrealized loss position to determine if the impairment is temporary or other than temporary. This evaluation encompasses various factors including, the nature of the investment, the cause of the impairment, the severity and duration of the impairment, credit ratings and other credit related factors such as third party guarantees and the volatility of the security's fair value. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due primarily to interest rate changes, and the Company does not intend to sell the securities and it is not likely that the Company will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security. As of December 31, 2018, we did not have any investment securities that constituted 10% or more of the stockholders' equity of any third-party issuer.

The following table summarizes the maturity and repricing schedule of our debt investment securities, which does not include equity securities, at their amortized cost and their weighted average yields at December 31, 2018:

Debt Investment Maturities and Repricing Schedule

(Dollars in Thousands)	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years		Total	
	Amount	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**
Available-for-sale:										
U.S. agencies	$10,199	1.02 %	$2,885	3.16 %	$5,442	3.12 %	$25,948	2.68 %	$44,474	2.38 %
Collateralized mortgage obligations	0	0.00 %	0	0.00 %	0	0.00 %	2,071	2.67 %	2,071	2.67 %
Municipalities	20,749	3.08 %	47,288	3.09 %	21,150	4.00 %	3,070	4.93 %	92,257	3.36 %
SBA pools	0	0.00 %	0	0.00 %	3,215	4.16 %	5,492	3.92 %	8,707	4.01 %
Corporate debt	6,024	3.06 %	4,844	3.67 %	10,558	3.08 %	0	0.00 %	21,426	3.21 %
Asset backed securities	0	0.00 %	0	0.00 %	6,042	4.08 %	32,353	3.82 %	38,395	3.86 %
Total debt securities	$36,972	2.51 %	$55,017	3.15 %	$46,407	3.71 %	$68,934	3.41 %	$207,330	3.25 %

Yields in the above table have been adjusted to a fully tax equivalent basis. Securities are reported at the earliest possible call, repricing or maturity date.

Loans

The following table sets forth the amount of total loans outstanding (including unearned income) and the percentage distributions in each category, as of the dates indicated.

(Dollars in Thousands)	YEARS ENDED DECEMBER 31,				
	2018	**2017**	**2016**	**2015**	**2014**
Commercial real estate	$554,519	$517,150	$478,855	$423,047	$358,398
Commercial and industrial	82,252	69,610	64,201	63,776	54,051
Consumer	1,314	689	767	774	805

Consumer residential	35,741	37,161	38,672	32,588	25,464
Agriculture	38,076	37,934	28,454	20,847	15,753
Unearned income	(997)	(1,389)	(2,013)	(3,282)	(446)
Total Loans, net of unearned income	$710,905	$661,155	$608,936	$537,750	$454,025
Participation loans sold and serviced by the Bank	22,119	19,722	21,348	19,848	16,243
Commercial real estate	78.0 %	78.2 %	78.6 %	78.7 %	78.9 %
Commercial and industrial	11.6 %	10.5 %	10.5 %	11.9 %	11.9 %
Consumer	0.2 %	0.1 %	0.1 %	0.1 %	0.2 %
Consumer residential	5.0 %	5.6 %	6.4 %	6.1 %	5.6 %
Agriculture	5.4 %	5.7 %	4.7 %	3.9 %	3.5 %
Unearned income	-0.1 %	-0.2 %	-0.3 %	-0.6 %	-0.1 %
Total Loans, net of unearned income	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %

Commercial real estate loans increased $37,369,000 in 2018 as compared to 2017, due to the increased demand by qualified borrowers in our serving area. Of the commercial real estate loans at December 31, 2018, 60% are non-owner occupied and 40% are owner occupied. Our commercial real estate loan portfolio is weighted towards term loans for which the primary source of repayment is cash flow from net operating income of the real estate property.

Commercial and industrial loans increased $12,642,000 in 2018 as compared to 2017. We have historically targeted well-established local businesses with strong guarantors that have proven to be resilient in periods of economic stress.

Our residential loan portfolio includes no sub-prime loans, nor is it our normal practice to underwrite loans commonly referred to as "Alt-A mortgages", the characteristics of which are loans lacking full documentation, borrowers having low FICO scores or collateral compositions reflecting high loan-to-value ratios. Substantially all of our residential loans are indexed to Treasury Constant Maturity Rates and have provisions to reset five years after their origination dates.

The following table summarizes our commercial real estate loan portfolio by the geographic location in which the property is located as of December 31, 2018 and 2017:

Commercial Real Estate Loans Outstanding by Geographic Location

(Dollars in Thousands)	**December 31, 2018**			**December 31, 2017**		
Commercial real estate loans by geographic location (County)	**Amount**	**% of Commercial Real Estate Loans**		**Amount**	**% of Commercial Real Estate Loans**	
Stanislaus	$157,945	28.5	%	$173,479	33.5	%
San Joaquin	122,900	22.2	%	90,275	17.5	%
Sacramento	42,312	7.6	%	20,501	4.0	%
Tuolumne	34,515	6.2	%	33,648	6.5	%
Fresno	31,256	5.6	%	35,711	6.9	%
Merced	16,458	3.0	%	17,276	3.3	%
Contra Costa	14,381	2.6	%	10,373	2.0	%
Marin	12,233	2.2	%	12,658	2.4	%
Madera	9,517	1.7	%	9,766	1.9	%
Santa Clara	9,443	1.7	%	2,784	0.5	%
Calaveras	9,089	1.6	%	8,399	1.6	%
Sonoma	8,155	1.5	%	8,544	1.7	%
San Luis Obispo	7,628	1.4	%	11,424	2.2	%
Inyo	6,802	1.2	%	7,176	1.4	%
Alameda	5,626	1.0	%	6,675	1.3	%
San Francisco	5,405	1.0	%	5,521	1.1	%

Solano	5,363	1.0 %	5,311	1.0 %
Mono	5,113	0.9 %	6,529	1.3 %
Butte	4,424	0.8 %	4,162	0.8 %
Other	45,954	8.3 %	46,938	9.1 %
Total	**$554,519**	**100.0 %**	**$517,150**	**100.0 %**

Construction and land loans are classified as commercial real estate loans and decreased $10.1 million in 2018 as compared to 2017. The table below shows an analysis of construction loans by type and location. Non-owner-occupied land loans of $11.0 million at December 31, 2018 included loans for lands specified for commercial development of $6.6 million and for residential development of $4.4 million, the majority of which are located in Stanislaus County.

Construction and Land Loans Outstanding by Type and Geographic Location

(Dollars in Thousands)	**December 31, 2018**			**December 31, 2017**		
Construction and land loans by type	**Amount**	**% of Construction and Land Loans**		**Amount**	**% of Construction and Land Loans**	
Single family non-owner-occupied	$2,276	7.3	%	$1,040	2.5	%
Single family owner-occupied	2,169	6.9	%	1,039	2.5	%
Commercial non-owner-occupied	9,328	29.9	%	20,989	50.8	%
Commercial owner-occupied	6,490	20.8	%	8,197	19.8	%
Land non-owner-occupied	10,951	35.1	%	10,072	24.4	%
Total	**$31,214**	**100.0**	**%**	**$41,337**	**100.0**	**%**

Construction and land loans by geographic location (County)	**Amount**	**% of Construction and Land Loans**		**Amount**	**% of Construction and Land Loans**	
San Joaquin	$10,653	34.1	%	$4,994	12.1	%
Stanislaus	6,034	19.3	%	4,954	12.0	%
Tuolumne	3,069	9.8	%	1,395	3.4	%
Shasta	2,033	6.5	%	1,222	2.9	%
Sacramento	1,728	5.5	%	600	1.4	%
Calaveras	1,640	5.3	%	402	1.0	%
Los Angeles	1,600	5.1	%	3,687	8.9	%
Contra Costa	1,151	3.7	%	975	2.3	%
Mono	932	3.0	%	1,767	4.3	%
Fresno	840	2.7	%	9,782	23.7	%
San Mateo	442	1.4	%	1,940	4.7	%
Inyo	13	0.1	%	39	0.1	%
Placer	0	0.0	%	6,804	16.5	%
Solano	0	0.0	%	1,505	3.6	%
Monterey	0	0.0	%	898	2.2	%

Other	1,079	3.5	%	373	0.9	%
Total	**$31,214**	**100.000**	**%**	**$41,337**	**100.0**	**%**

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Loan Maturities

The following table shows the contractual maturity distribution and repricing intervals of the outstanding loans in our portfolio, as of December 31, 2018. In addition, the table shows the distribution of such loans between those with variable or floating interest rates and those with fixed or predetermined interest rates. The large majority of the variable rate loans are tied to independent indices (such as the Wall Street Journal prime rate or a Treasury Constant Maturity Rate). Substantially all loans with an original term of more than five years have provisions for the fixed rates to reset, or convert to a variable rate, after one, three or five years and are therefore classified as a variable rate loan in the table below.

Loan Maturities and Repricing Schedule
At December 31, 2018

	Within One Year	**After One but Within Five Years**	**After Five Years**	**Total**
Commercial real estate	$101,777	$279,086	$173,656	$554,519
Commercial & industrial	42,625	24,548	15,079	82,252
Consumer	822	430	62	1,314
Consumer residential	3,770	9,464	22,507	35,741
Agriculture	34,876	3,200	0	38,076
Unearned income	(261)	(448)	(287)	(996)
Total loans, net of unearned income	$183,610	$316,280	$211,015	$710,905
Loans with variable (floating) interest rates	$155,778	$244,263	$89,235	$489,276
Loans with predetermined (fixed) interest rates	$27,833	$72,018	$121,780	$221,631

The majority of the properties taken as collateral are located in Northern California. We employ strict guidelines regarding the use of collateral located in less familiar market areas. Positive trends in Northern California real estate values, the low loan-to-value ratios in our commercial real estate portfolio, and the high percentage of owner-occupied properties further solidify our credit quality position.

Nonperforming Assets

Financial institutions generally have a certain level of exposure to credit quality risk and could potentially receive less than a full return of principal and interest if a debtor becomes unable or unwilling to repay. Since loans are the most significant assets of the Company and generate the largest portion of its revenues, the Company's management of credit quality risk is focused primarily on loan quality. Banks have generally suffered their most severe earnings declines due to customers' inability to generate sufficient cash flow to service their debts and/or downturns in national and regional economies which have brought about declines in overall property values. In addition, certain debt securities that the Company may purchase have the potential of declining in value if the obligor's financial capacity to repay deteriorates.

Nonperforming assets consist of loans on non-accrual status, loans 90 days or more past due and still accruing interest, loans restructured, where the terms of repayment have been renegotiated resulting in a reduction or deferral of interest or principal and OREO.

Loans are generally placed on non-accrual status when they become 90 days past due, unless management believes the loan is adequately collateralized and in the process of collection. The past due loans may or may not be adequately collateralized, but collection efforts are continuously pursued. Loans may be restructured by management when a borrower has experienced some changes in financial status, causing an inability to meet the original repayment terms, and where we believe the borrower will eventually overcome those circumstances and repay the loan in full. OREO consists of properties acquired by foreclosure or similar means and which management intends to offer for sale.

The Company had nonperforming loans of $0.9 million at December 31, 2018, as compared to $1.31 million at December 31, 2017, $3.04 million at December 31, 2016, $5.82 million at December 31, 2015 and $4.70 million at December 31, 2014. The ratio of nonperforming loans over total loans was 0.13%, 0.20%, 0.50%, 1.07% and 1.03% at December 31, 2018, 2017, 2016, 2015 and 2014, respectively.

In addition, the Company held one OREO property as of December 31, 2018, a residential land property that was acquired through foreclosure that was written down to a zero balance because the public utilities have not been obtainable, thereby rendering these land lots unmarketable at this time. The Company held two OREO properties with outstanding balances of approximately $253,000 as of December 31, 2017, three OREO properties with outstanding balances of approximately $1,210,000 as of December 31, 2016, five OREO properties with outstanding balances of approximately $2,066,000 as of December 31, 2015 and held three properties with balances of approximately $884,000 as of December 31, 2014.

Management believes that the reserve provided for nonperforming loans, together with the tangible collateral, were adequate as of December 31, 2018. See “Allowance for Loan Losses” below for further discussion. Except as disclosed above, as of December 31, 2018, management was not aware of any material credit problems of borrowers that would cause it to have serious doubts about the ability of a borrower to comply with the present loan payment terms. However, no assurance can be given that credit problems may exist that may not have been brought to the attention of management, or that credit problems may not arise in the future.

The following table provides information with respect to the components of our nonperforming assets as of the dates indicated. (The figures in the table are net of the portion guaranteed by the U.S. Government):

(Dollars in Thousands)	**At December 31,**				
	2018	**2017**	**2016**	**2015**	**2014**
Nonaccrual loans(1)					
Commercial real estate	$906	$993	$2,715	$2,790	$4,363
Commercial and industrial	0	302	306	322	337
Consumer	0	0	0	0	0
Consumer residential	14	16	16	0	0
Agriculture	0	0	0	2704	0
Total	$920	$1,311	$3,037	$5,816	$4,700
Loans 90 days or more past due and still accruing (as to principal or interest):					
Commercial real estate	$0	$0	$0	$0	$0
Commercial and industrial	0	0	0	0	0
Consumer	0	0	0	0	0
Consumer residential	0	0	0	0	0
Agriculture	0	0	0	0	0
Total	0	0	0	0	0
Total nonperforming loans	920	1,311	3,037	5,816	4,700
Other real estate owned	0	253	1,210	2,066	884
Total nonperforming assets	$920	$1,564	$4,247	$7,882	$5,584
Accruing restructured loans (2)					
Commercial real estate	$0	$0	$0	$0	$0
Commercial and industrial	0	0	0	0	0
Consumer	0	0	0	0	0
Consumer residential	0	0	0	0	0
Agriculture	0	0	0	0	0
Total	0	0	0	0	0
Total impaired loans	$920	$1,311	$3,037	$5,816	$4,700
Nonperforming loans as a percentage of total loans	0.20 %	0.20 %	0.50 %	1.07 %	1.03 %
Nonperforming assets as a percentage of total loans and other real estate owned	0.24 %	0.24 %	0.69 %	1.45 %	1.23 %
Allowance for loan losses as a percentage of nonperforming loans	622.88 %	622.88 %	257.89 %	126.48 %	160.30 %

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(1)

During the fiscal year ended December 31, 2018 and 2017, no interest income related to these loans was included in net income while on nonaccrual status. Additional interest income of approximately $68,000 and $114,000 would have been recorded during the year ended December 31, 2018 and 2017, respectively, if these loans had been paid in accordance with their original terms.

(2) A "restructured loan" is one the terms of which were renegotiated to provide a concession because of deterioration in the financial position of the borrower.

Allowance for Loan Losses

In anticipation of credit risk inherent in our lending business, we set aside allowances through charges to earnings. Such charges are not only made for the outstanding loan portfolio, but also for off-balance sheet items, such as commitments to extend credits or letters of credit. The charges made for the outstanding loan portfolio are credited to the allowance for loan losses, whereas charges for off-balance sheet items are credited to the reserve for off-balance sheet items, which is presented as a component of other liabilities. The provision for loan losses is discussed in the section entitled “Provision for Loan Losses” above.

The balance of our allowance for loan losses is management's best estimate of the probable losses inherent in the portfolio. The ultimate adequacy of the allowance is dependent upon a variety of factors beyond our control, including the real estate market, changes in interest rate and economic and political environments.

Historically, over the past five years, the economic recovery has had a positive impact on the financial stability of our borrowers resulting in improvements in credit quality of our loan portfolio which has allowed us to reduce the reserve for loan losses. In 2018, we have continued to benefit from the improved credit quality but due to strong loan growth, we recognized an increase of $519,000 in the allowance for loan losses to $8,685,000 at December 31, 2018, as compared with $8,166,000 at December 31, 2017. Such allowances were $7,832,000, $7,356,000 and $7,534,000 at December 31, 2016, 2015 and 2014, respectively. In 2018, the allowance for loan losses as a percentage of total loans decreased corresponding to our improved credit quality and loan growth, as reflected in the ratios of 1.22%, 1.23%, 1.28%, 1.36% and 1.66%, at the end of 2018, 2017, 2016, 2015 and 2014, respectively. The decrease at the end of 2015, and to a lesser degree in 2016 and 2017, is due in part to the acquisition of $42,831,000 in loans from a business combination which are recorded at fair value and therefore do not require a loan loss reserve. Based on the current conditions of the loan portfolio, management believes that the $8,685,000 allowance for loan losses at December 31, 2018 is adequate to absorb losses inherent in our loan portfolio. No assurance can be given, however, that adverse economic conditions or other circumstances will not result in increased losses in the portfolio.

Diversification, low loan-to-values, strong credit quality and enhanced credit monitoring contribute to a reduction in the portfolio’s overall risk and help to offset the economic risk. The impact of the economic environment will continue to be monitored, and adjustments to the provision for loan loss will be made accordingly. During 2018, the Company recognized net loan charge-offs of $36,000 as compared to $16,000, $8,000 and $53,000 in 2017, 2016 and 2015, respectively. In 2014, we recorded net loan recoveries of $1,752,000, primarily from one loan for which we received a net settlement of $2,923,000, resulting in a recovery of $1,877,000.

Management reviews these conditions with our senior credit officers. To the extent that any of these conditions is evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management’s estimate of the effect of such condition may be reflected as a specific allowance applicable to such credit or portfolio segment. Where any of these conditions is not evidenced by a specific, identifiable problem credit or portfolio segment as of the evaluation date, management's evaluation of the inherent loss related to such condition is reflected in the unallocated allowance. Although management has allocated a portion of the allowance to specific loan categories, the adequacy of the allowance is considered in its entirety.

As of December 31, 2018, our allowance for loan losses consisted of amounts allocated to three phases of our methodology for assessing loan loss allowances, as follows (see details of methodology for assessing allowance for loan losses in the section entitled "Critical Accounting Policies"):

(Dollars in Thousands)	**Years Ended December 31,**		
Phase of Methodology	**2018**	**2017**	**2016**
Specific review of individual loans	$680	$680	$680
Review of portfolio based on loss trends and current economic climate	5,051	4,780	4,543
Review of portfolio based on inherent risk and other subjective factors	2,954	2,706	2,609
	$8,685	$8,166	$7,832

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The Components of the Allowance for Loan Losses

As stated previously in "Critical Accounting Policies," the overall allowance consists of a specific allowance for individually identified impaired loans, an allowance factor for categories of credits with similar characteristics and trends, and an allowance for changing environmental factors.

The first component, the specific allowance, results from the analysis of identified problem credits and the evaluation of sources of repayment including collateral, as applicable. Through management's ongoing loan grading process, individual loans are identified that have conditions that indicate the borrower may be unable to pay all amounts due under the contractual terms. These loans are evaluated individually by management and specified allowances for loan losses are established when the discounted cash flows of future payments or collateral value of collateral-dependent loans are lower than the recorded investment in the loan. Generally, with problem credits that are collateral-dependent, we obtain appraisals of the collateral at least annually. We may obtain appraisals more frequently if we believe the collateral value is subject to market volatility, if a specific event has occurred to the collateral (e.g. tentative map has been filed), or if we believe foreclosure is imminent. Impaired loan balances decreased from $1,311,000 at December 31, 2017 to $920,000 at December 31, 2018. The specific allowance totaled $680,000 at December 31, 2018 and 2017, as we charge off substantially all of our estimated losses related to specifically identified impaired loans as the losses are identified.

The second component, the allowance factor, is an estimate of the probable inherent losses in each loan pool stratified by major categories or loans with similar characteristics in our loan portfolio. This analysis encompasses segmenting and reviewing historical losses, loan grades by pool and current general economic and business conditions. Confirmation of the quality of our grading process is obtained by independent reviews conducted by consultants specifically hired for this purpose and by various bank regulatory agencies. This analysis covers our entire loan portfolio but excludes any loans that were analyzed individually for specific allowances as discussed above. There are limitations to any credit risk grading process. The number of loans makes it impractical to review every loan every quarter. Therefore, it is possible that in the future, some currently performing loans not recently graded will not be as strong as their last grading and an insufficient portion of the allowance will have been allocated to them. Grading and loan review often must be done without knowing whether all relevant facts are at hand. Troubled borrowers may deliberately or inadvertently omit important information from reports or conversations with lending officers regarding their financial condition and the diminished strength of repayment sources.

The total amount allocated for the second component is determined by applying loss estimation factors based on loss history to outstanding loans. At December 31, 2018 and 2017, the allowance allocated by categories of credits totaled $5.1 million and $4.8 million, respectively.

The third component of the allowance for loan losses is an economic and qualitative component that is intended to absorb losses caused by portfolio trends, concentration of credit, growth, and economic trends, as stated previously in

"Critical Accounting Policies". At December 31, 2018 and 2017, the general valuation allowance, including the economic component, totaled $3.0 million and $2.7 million, respectively. While published economic data indicates that the current economic recovery cycle is approaching 10 years, which would be the longest in U.S history, it is uncertain that the recovery cycle will continue for any definite period of time. In response to this, we have been proactive in evaluating reserve percentages for economic and other qualitative loss factors used to determine the adequacy of the allowance for loan losses. The increase to the third component of the allowance for loan losses reflected such evaluation.

The table below summarizes, for the periods indicated, loan balances at the end of each period, the daily averages during the period, changes in the allowance for loan losses arising from loans charged off, recoveries on loans previously charged off, additions to the allowance and certain ratios related to the allowance for loan losses:

Allowance for Loan Losses

(Dollars in thousands)	**2018**	**2017**	**2016**	**2015**	**2014**
Balances:					
Average total loans outstanding during period	$657,896	$624,447	$578,339	$466,509	$430,448
Total loans outstanding at end of period	$711,902	$662,544	$610,949	$541,032	$454,471
Allowance for loan losses:					
Balances at beginning of period	$8,166	$7,832	$7,356	$7,534	$7,659
Actual charge-offs:					
Commercial real estate	0	0	0	0	103
Commercial and Industrial	0	0	0	32	0
Consumer	29	30	18	30	40
Consumer Residential	17	0	0	0	0
Agriculture	0	0	0	0	0
Total charge-offs	46	30	18	62	143
Recoveries on loans previously charged off:					
Commercial real estate	0	0	4	5	1,882
Commercial and Industrial	0	0	0	0	0
Consumer	8	13	5	4	2
Consumer Residential	2	1	1	0	11
Agriculture	0	0	0	0	0
Total recoveries	10	14	10	9	1,895
Net loan charge-offs (recoveries)	36	16	8	53	(1,752)
Provision (reversal) for loan losses	555	350	484	(125)	(1,877)
Balance at end of period	$8,685	$8,166	$7,832	$7,356	$7,534
Ratios:					
Net loan charge-offs (recoveries) to average total loans	0.01%	0.00%	0.00%	0.01%	-0.41%
Allowance for loan losses to total loans at end of period	1.22%	1.23%	1.28%	1.36%	1.66%
Net loan charge-offs (recoveries) to allowance for loan losses at end of period	0.41%	0.20%	0.10%	0.72%	-23.25%
Net loan charge-offs to provision for loan losses	6.49%	4.57%	1.65%	N/A	N/A

The table below summarizes the allowance for loan loss balance by type of loan balance at the end of each period (See "Loan Portfolio" above for a description of each type of loan balance):

Allocation of the Allowance for Loan Losses

(Dollars in thousands)	**Amount Outstanding as of December 31,**				
	2018	**2017**	**2016**	**2015**	**2014**
Applicable to:					
Commercial real estate	$6,580	$6,331	$6,185	$5,920	$5,963
Commercial and Industrial	1,065	813	697	627	720
Consumer	39	27	51	38	42
Consumer Residential	304	300	325	426	388
Agriculture	693	693	504	309	286
Unallocated	4	2	70	36	135
Total Allowance	$8,685	$8,166	$7,832	$7,356	$7,534

Other Earning Assets

For various business purposes, we make investments in earning assets other than the interest-earning securities and loans discussed above. The primary other earning assets held by the Company as of December 31, 2018 and 2017, includes the cash surrender value of the Bank Owned Life Insurance ("BOLI") policies, Federal Home Loan Bank stock and Federal Reserve Bank stock. During 2018, we committed to invest $5 million in a new low-income housing tax credit fund ("LIHTCF") to promote our participation in CRA activities, which had an unfunded commitment of $3,593,000 as of December 31, 2018. As of December 31, 2018 and 2017, we held another LIHTC investment that we've participated in since 2006, for which the original investment was $1 million, and there were no unfunded commitments as of December 31, 2018 and 2017. For both LIHTC investments, we receive the return in the form of tax credits and tax deductions over a period of approximately 15 years. In 2017, we made a $1 million commitment as a limited partner, to a small business private equity partnership to promote our participation in CRA activities. Returns will be received in the form of dividends from the general partner. As of December 31, 2018, we have remaining commitments to fund an additional $600,000 on this investment.

The balances of other earning assets as of December 31, 2018 and December 31, 2017 were as follows:

(Dollars in Thousands)

	December 31, 2018	December 31, 2017
BOLI	$ 19,029	$ 18,517
LIHTCFs	$ 5,076	$ 266
Small business private equity partnership	$ 400	$ 280
Federal Reserve Bank Stock	$ 758	$ 758
Federal Home Loan Bank Stock	$ 3,599	$ 3,377

Deposits and Other Sources of Funds

Deposits

Total deposits at December 31, 2018 and 2017 were $986,495,000 and $938,882,000, respectively, representing an increase of $47,613,000 or 5.1% in 2018. The average deposits for the year ended December 31, 2018 increased $59,021,000 or 6.5% to $967,980,000 compared to $908,959,000 at December 31, 2017.

Deposits are the Company's primary source of funds. Due to strategic emphasis by management, core deposits (based on definition provided by FDIC's Uniform Bank Performance Report) increased by $49.2 million or 5.4% in 2018 to $968.0 million at December 31, 2018. The percentage of core deposits to total deposits increased slightly to 98.1% at December 31, 2018 as compared to 97.9% at December 31, 2017. The average rate paid on time deposits in denominations of over $250,000 was 0.36% and 0.37% for the years ended December 31, 2018 and 2017, respectively. The composition and cost of the Company's deposit base are important components in analyzing the Company's net interest margin and balance sheet liquidity characteristics, both of which are discussed in greater detail in other sections herein. See "Net Interest Income and Net Interest Margin" for further discussion.

The Company's liquidity is impacted by the volatility of deposits or other funding instruments or, in other words, by the propensity of that money to leave the institution for rate-related or other reasons. Deposits can be adversely affected if economic conditions in California and the Company's market area in particular, continue to weaken. Potentially, the most volatile deposits in a financial institution are jumbo certificates of deposit, meaning time deposits with balances that equal or exceed $250,000, as customers with balances of that magnitude are typically more rate-sensitive than customers with smaller balances.

The following tables summarize the distribution of average daily deposits and the average daily rates paid for the periods indicated:

Distribution of Average Daily Deposits

	Average Deposits								
	2018			**2017**			**2016**		
(Dollars in Thousands)	**Average Balance**	**Average Rate**		**Average Balance**	**Average Rate**		**Average Balance**	**Average Rate**	
Demand	$559,639	0.22	%	$498,306	0.06	%	$427,224	0.04	%
Money market	288,454	0.32	%	289,155	0.19	%	287,010	0.11	%
Savings	74,317	0.05	%	69,348	0.07	%	74,669	0.16	%
Time certificates of deposit of $250,000 or more	18,725	0.36	%	20,273	0.37	%	19,560	0.32	%
Other time deposits	26,845	0.27	%	31,877	0.30	%	33,356	0.32	%
Total deposits	$967,980	0.17	%	$908,959	0.12	%	$841,819	0.09	%

The scheduled maturities of our time deposits in denominations of more than $250,000 at December 31, 2018 are, as follows:

Maturities of Time Deposits over $250,000

(Dollars in Thousands)

Three months or less	$	2,165
Over three months through six months		529
Over six months through twelve months		4,043
Over twelve months		11,759
Total	$	18,496

Because our client base is comprised primarily of commercial and industrial accounts, individual account balances are generally higher than those of consumer-oriented banks. Seven of our clients carry deposit balances of more than 1% of our total deposits, one of which had a deposit balance of more than 3% of total deposits at December 31, 2018. The Company had no brokered deposits as of December 31, 2018 and 2017.

FHLB Borrowings

Although deposits are the primary source of funds for our lending and investment activities and for general business purposes, we may obtain advances from the Federal Home Loan Bank of San Francisco (“FHLB”) as an alternative to retail deposit funds. We had no outstanding balances as of December 31, 2018 and 2017 or at any time during 2018 and 2017. See “Liquidity Management” below for the details on the FHLB borrowings program.

Return on Equity and Assets

The following table sets forth certain information regarding our return on equity and assets for the periods indicated:

	Year Ended December 31,	
	2018	**2017**
Return on average assets	1.08 %	0.91 %
Return on average common equity	12.26%	10.41%
Dividend payout ratio	18.31%	22.23%
Equity to assets ratio	9.05 %	8.77 %

Deferred Compensation Obligations

We maintain a nonqualified, unfunded deferred compensation plan for certain key management personnel. Under this plan, participating employees may defer compensation, which will entitle them to receive certain payments upon retirement, death, or disability. The plan provides for payments commencing upon retirement and reduced benefits upon early retirement, disability, or termination of employment. At December 31, 2018 and 2017, our aggregate payment obligations under this plan totaled $8.0 million.

Off-Balance Sheet Arrangements

During the ordinary course of business, we provide various forms of credit lines to meet the financing needs of our customers. These commitments, which represent a credit risk to us, are not represented in any form on our balance sheets.

As of December 31, 2018, and 2017, we had commitments to extend credit of $153.9 million and $118.0 million, respectively. Obligations under standby letters of credit, included in total commitments to extend credit, were $2.3 million and $1.9 million at December 31, 2018 and 2017, respectively, and there were no obligations under commercial letters of credit for either period.

The effect on our revenues, expenses, cash flows and liquidity from the unused portion of the commitments to provide credit cannot be reasonably predicted because there is no guarantee that the lines of credit will be used. For more information regarding our off balance sheet arrangements, see Note 13- Commitments and Other Contingencies- to our 2018 year-end consolidated financial statements located elsewhere in this report.

Contractual Obligations

The following chart summarizes certain contractual obligations of the Company as of December 31, 2018 (dollars in thousands):

	Less than 1 year	1-3 years	3-5 years	More than 5 years	Total
Operating lease obligations	$1,102	$1,869	$1,173	$1,943	$6,087
Supplemental retirement plans	110	280	328	2,783	3,501
Time deposit maturities	36,611	5,506	195	-	42,312
Total	$37,823	$7,655	$1,696	$4,726	$51,900

As permitted or required under California law and to the maximum extent allowable under that law, we have certain obligations to indemnify our current and former officers and directors for certain events or occurrences while the officer or director is, or was serving, at our request in such capacity. These indemnification obligations are valid as long as the director or officer acted in good faith and in a manner the person reasonably believed to be in, or not opposed to, our best interests, and with respect to any criminal action or proceeding, had no reasonable cause to believe his or her conduct was unlawful. The maximum potential amount of future payments that we could be required to make under these indemnification obligations is unlimited; however, we have a director and officer insurance policy that mitigates our exposure and enables us to recover a portion of any future amounts paid. We believe the estimated fair value of these indemnification obligations is minimal.

Liquidity and Asset/Liability Management

Management seeks to ascertain optimum and stable utilization of available assets and liabilities as a vehicle to attain our overall business plans and objectives. In this regard, management focuses on measurement and control of liquidity risk, interest rate risk and market risk, capital adequacy, operation risk and credit risk.

Liquidity

Liquidity to meet borrowers' credit and depositors' withdrawal demands is provided by maturing assets, short-term liquid assets that can be converted to cash and the ability to attract funds from depositors. Additional sources of liquidity may include institutional deposits, advances from the FHLB and other short-term borrowings, such as federal funds purchased.

Since our deposit growth strategy emphasizes core deposit growth, we have avoided relying on brokered deposits as a consistent source of funds. The Company had no brokered deposits as of December 31, 2018 and 2017.

As a secondary source of liquidity, we rely on advances from the FHLB to supplement our supply of lendable funds and to meet deposit withdrawal requirements. Advances from the FHLB are typically secured by a portion of our loan portfolio and stock issued by the FHLB. The FHLB determines limitations on the amounts of advances by assigning a percentage to each eligible loan category that will count towards the borrowing capacity. At December 31, 2018 and 2017, the Company had no FHLB advances outstanding and had sufficient collateral to borrow an additional $268.9 million and $249.2 million, respectively. In addition, the Company had lines of credit with its correspondent banks to purchase overnight federal funds totaling $30 million at December 31, 2018 and 2017, respectively. No advances were made on these lines of credit as of December 31, 2018 and 2017.

The Company's liquidity depends primarily on dividends paid to it as the sole shareholder of the Bank. The Bank's ability to pay dividends to the Company will depend on whether the Bank will be in a position to pay dividends based on regulatory requirements and the performance of the Bank.

Maintenance of adequate liquidity requires that sufficient resources be available at all time to meet our cash flow requirements. Liquidity in a banking institution is required primarily to provide for deposit withdrawals and the credit needs of its customers and to take advantage of investment opportunities as they arise. Liquidity management involves our ability to convert assets into cash or cash equivalents without incurring significant loss, and to raise cash or maintain funds without incurring excessive additional cost. For this purpose, we maintain a portion of our funds in cash and cash equivalents, loans and securities available for sale. Our liquid assets at December 31, 2018 and 2017 totaled approximately $238.5 million and $254.8 million, respectively. Our liquidity level measured as the percentage of liquid assets to total assets was 21.8% and 24.6% at December 31, 2018, and 2017, respectively.

Capital Resources and Capital Adequacy Requirements

In the past two years, our primary source of capital has been internally generated operating income through retained earnings. At December 31, 2018, total shareholders' equity increased to $99.0 million, representing an increase of $8.3 million from December 31, 2017. The increase was due to net income of $11.5 million recorded to retained earnings, which was offset in part by other comprehensive loss of $1.6 million, net of income taxes, due to the negative effect that rising treasury yields had on the unrealized market value adjustment of our available for sale investment portfolio during 2018. Also, retained earnings was reduced by the common stock dividend payments totaling $2.1 million during 2018. As of December 31, 2018, we had no material commitments for capital expenditures.

We are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can trigger regulatory actions that could have a material adverse effect on our financial statements and operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that rely on the quantitative measures of our assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. (See "Description of Business-Regulation and Supervision-Capital Adequacy Requirements" in this report for exact definitions and regulatory capital requirements.)

As of December 31, 2018, we were qualified as a "well capitalized institution" under the regulatory framework for prompt corrective action. The following table presents the regulatory standards for well-capitalized institutions, compared to the Bank's capital ratios as of the dates specified:

	Regulatory Well-Capitalized Standards		**December 31, 2018**		**December 31, 2017**	
Total capital to risk-weighted assets	10.0	%	11.7	%	11.3	%
Tier I capital to risk-weighted assets	8.0	%	10.7	%	10.3	%
Common equity tier 1 risk-weighted assets	6.5	%	10.7	%	10.3	%
Tier I capital to average assets	5.0	%	8.7	%	8.4	%

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

Documents Filed as Part of this Report:

(a)(1) Financial Statements

The Financial Statements of the Company and the Report of Independent Registered Public Accounting Firm are set forth on pages F-1 through F-46.

(a)(2) Financial Statement Schedules

All schedules to the Financial Statements are omitted because of the absence of the conditions under which they are required or because the required information is included in the Financial Statements or accompanying notes.

(a)(3) Exhibits

INDEX TO EXHIBITS

Exhibit Number	Description
2.1	Agreement and Plan of Merger between the Registrant, Interim Oak Valley Bancorp, Inc. and Oak Valley Community Bank (incorporated by reference to Exhibit 2.1 to the Form 10 filed on July 31, 2008).
3.1	Articles of Incorporation of Oak Valley Bancorp, Inc. (incorporated by reference to Exhibit 3.1 to the Form 10 filed on July 31, 2008).
3.2	First Amendment to Articles of Incorporation of Oak Valley Bancorp, Inc. (incorporated by reference to Exhibit 3.2 to the Form 10 filed on July 31, 2008).

3.3	Bylaws of Oak Valley Bancorp, Inc. (incorporated by reference to Exhibit 3.3 to the Form 10 filed on July 31, 2008).
3.4	First Amended and Restated Bylaws of Oak Valley Bancorp, Inc. (incorporated by reference to Exhibit 3.5 to the Form 8-A filed on January 14, 2009)
3.5	Certificate of Determination dated December 2, 2008 and filed with the California Secretary of State for Fixed Rate Cumulative Perpetual Preferred Stock, Series A (incorporated by reference to Exhibit 3.4 to the Form 8-A filed on January 14, 2009)
3.6	Letter Agreement between the United States Department of the Treasury and Oak Valley Bancorp dated December 5, 2008 (incorporated by reference to Exhibit 10.4 to the Form 8-A filed on January 14, 2009)
3.7	Certificate of Amendment of Bylaws dated effective as of August 11, 2011 (incorporated by reference to Exhibit 3.5 to the Form 10-Q filed on November 14, 2011).
3.8	Amendment of Bylaws (incorporated by reference to Exhibit 3.2 to the Form 8-K filed on July 22, 2013).
3.9	Certificate of Determination dated August 11, 2011 and filed with the California Secretary of State for Senior Non-Cumulative Perpetual Preferred Stock, Series B (incorporated by reference to Exhibit 4.3 to the Form 10-Q filed on November 14, 2011).
4.1	Warrant to Purchase Common Stock dated December 5, 2008 (incorporated by reference to Exhibit 10.4 to the Form 8-A filed on January 14, 2009).
10.1	Oak Valley Community Bank 1998 Restated Stock Option Plan (incorporated by reference to Exhibit 10.1 to the Form 10 filed on July 31, 2008).

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10.2	Oak Valley Community Bank Form of Director Retirement Agreement (incorporated by reference to Exhibit 10.2 to the Form 10 filed on July 31, 2008).
10.3	Oak Valley Community Bank Form of Salary Continuation Agreement (incorporated by reference to Exhibit 10.3 to the Form 10 filed on July 31, 2008).
10.4	Securities Purchase Agreement between Oak Valley Bancorp and the U.S. Treasury effective December 4, 2008 (incorporated by reference to Exhibit 10.4 to the Form 8-A filed on January 14, 2009).
10.5	Securities Purchase Agreement dated August 11, 2011 between the Company and the Secretary of the U.S. Treasury, with respect to the issuance and sale of Senior Non-Cumulative Perpetual Preferred Stock, Series B (incorporated by reference to Exhibit 10.1 to the Form 10-Q filed on November 14, 2011).
10.6	Warrant Redemption Letter Agreement dated September 28, 2011 between the Company and the U.S. Treasury, with respect to the redemption of the Warrant to Purchase Common Stock dated December 5, 2008 (incorporated by reference to Exhibit 10.2 to the Form 10-Q filed on November 14, 2011).
10.7	The First Amendment to the Oak Valley Community Bank Amended and Restated Salary Continuation Agreement with Christopher M. Courtney, dated July 1, 2016 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on June 9, 2017).†
10.8	The 2016 Salary Continuation Agreement with Christopher M. Courtney, dated July 1, 2016 (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed on June 9, 2017).†
10.9	The First Amendment to the Oak Valley Community Bank Amended and Restated Salary Continuation Agreement with Richard A. McCarty, dated July 1, 2016 (incorporated by reference to Exhibit 10.3 to the Company's Form 8-K filed on June 9, 2017).†
10.10	The 2016 Salary Continuation Agreement with Richard A. McCarty, dated July 1, 2016 (incorporated by reference to Exhibit 10.4 to the Company's Form 8-K filed on June 9, 2017).†
10.11	The First Amendment to the Oak Valley Community Bank Amended and Restated Salary Continuation Agreement with Michael J. Rodrigues, dated July 1, 2016 (incorporated by reference to Exhibit 10.5 to the Company's Form 8-K filed on June 9, 2017). †
10.12	The 2016 Salary Continuation Agreement with Michael J. Rodrigues, dated July 1, 2016 (incorporated by reference to Exhibit 10.6 to the Company's Form 8-K filed on June 9, 2017).†
10.13	The 2016 Salary Continuation Agreement with Jeffrey Gall, dated July 1, 2016 (incorporated by reference to Exhibit 10.7 to the Company's Form 8-K filed on June 9, 2017).†
10.14	Executive Employment Agreement between Richard A. McCarty and Oak Valley Bancorp dated March 20, 2018 (incorporated by reference to Exhibit 10.9 to the Form 10-Q filed on May 10, 2018).†
10.15	Oak Valley Bancorp 2018 Equity Incentive Plan (incorporated by reference to Appendix A of the Registrant's Proxy Statement for its 2018 Annual Meeting of Stockholders filed as of May 7, 2018). †
14	Code of Ethics (incorporated by reference to Exhibit 14 to the Form 10-K filed on March 31, 2009).

21 Subsidiaries of the Issuer (incorporated by reference to Exhibit 21 to the Form 10 filed on July 31, 2008).

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23.1	Consent of Independent Registered Public Accounting Firm.*
31.01	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.02	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.01	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**

* Previously filed with the Registrant's Form 10-K for the year ended December 31, 2018 that was filed with the Securities and Exchange Commission on March 11, 2019.

** Previously furnished with the Registrant's Form 10-K for the year ended December 31, 2018 that was filed with the Securities and Exchange Commission on March 11, 2019.

† Indicates management contract or compensatory plan.

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused Amendment No. 1 to this report to be signed on its behalf by the undersigned, thereunto duly authorized.

OAK VALLEY BANCORP

By: /s/ JEFFREY A. GALL
Jeffrey A. Gall
Chief Financial Officer

March 26, 2019

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