



2018 Annual Report

Central Valley
Community
Bancorp




2018 Letter to Shareholders

From California's snowcapped Sierra to our vibrant cityscapes and throughout the fertile farmland in between, our mission is growing strong.

Resilience & Responsiveness: What our shareholders, customers and communities deserve from their bank

We have a great deal to celebrate as we look back on 2018 – a year in which the Company emerged strong and successful by championing the values that have guided us from day one. As you'll see, confidence is high as we move closer to the Bank's 40-year milestone.

The Company entered 2018 with tremendous enthusiasm over the Bank's expansion in the Greater Sacramento market due to the Folsom Lake Bank acquisition and ended 2018 having achieved another year of record net income. Despite stock market adjustments that affected all financial stocks late in the year, the Company recorded \$1.54 diluted earnings per share for the year ended December 31, 2018, while raising the dividend three of four quarters and repurchasing shares of Company stock when we believed it was undervalued.

Total average assets for the year ended December 31, 2018, were \$1,577,410,000 compared to \$1,491,696,000 for the year ended December 31, 2017, an increase of 5.75%. Total average loans increased from \$793,343,000 for the year ended December 31, 2017, to \$912,128,000 for the year ended December 31, 2018, including the addition of the Folsom Lake Bank loans. Total average deposits increased 3.85% to \$1,333,754,000 for the year ended December 31, 2018.

As the nation's economy strengthened in 2018, the Federal Reserve raised short-term rates on three different occasions, flattening the yield curve. Our local economy faced some headwinds from the tariff issue and, to a lesser extent, the political divisions in California and the nation. Despite these trials, unemployment rates improved in our territory, supporting a tenth consecutive year of economic expansion. Reports of an impending recession continue to circulate, and while we are sensitive to those accounts, we see no indications in our local economy. The Company will remain vigilant to the full spectrum of economic scenarios, allowing us to react quickly should conditions change.

Branch Consolidations Reflect Consumer Trend, Improve Efficiency

Responding to changes in consumer banking preferences, as well as our ongoing desire to improve efficiency, branch changes were made in 2018. Our Caldwell and Folsom Prairie City offices were consolidated into other nearby Central Valley Community Bank branches in Visalia and Folsom, and the deposits of our Tracy office were sold to a local bank in the same market – in all cases, with great care for our clients and employees, and with an unwavering commitment to supporting the needs of our local communities.

These decisions were not easy, but our clients have shown us – and industry trends reflect – a major shift in how they want their financial services delivered. Branch visits are decreasing in favor of mobile and online banking technologies. While we see the power of having a physical presence to meet client needs, it is clear that we must continue to serve clients when and where they are – whether or not that is with a physical branch.

These transitions will allow us to better meet the needs of our customers and shareholders, improve our technology-driven banking services, and invest in continued growth initiatives for the entire Bank.

Keeping Our Customers Safe & Secure

Central Valley Community Bank proudly unveiled Card Valet in 2018, a powerful new security technology available through a mobile app that allows customers to safeguard their debit cards by instantly "turning them off" if they become lost or stolen, and back "on" when they are ready to be used.

For the 12th consecutive year, the Bank hosted its Free Document Shredding events with partner, Pacific Shredding. Held annually at the height of tax season, the events were held at 20 Bank branch and neighboring locations. Throughout the campaign, nearly 2,500 individuals and businesses brought over 118,000 pounds of sensitive documents to be shredded safely and securely at no charge, and learned helpful tips for protecting themselves from identity theft and cybercrimes.

Jim Ford had the honor of joining the former President and CEO of Western Bankers Association, Simone Lagomarsino, and Entercom Radio Sacramento for The Public File, a thirty minute public service program that aired on six top radio stations, focusing on avoiding identity theft and cybercrimes. Subjects discussed included the steps to take if you or your business is impacted by identity theft, and the Western Bankers Association shared recent advances banks have implemented to ensure the protection of their customers' information.

The Bank was a proud sponsor and active participant in the 2018 Cybersecurity Summit presented by the Fresno Police Department and Bitwise Industries. Created to raise awareness of the dangers of cybercrime and what can be done to prevent it, the summit targeted businesses in a four county region that had most recently experienced some serious cyberattacks. The event was sold out and attendees left with valuable information for their organizations.

Honors For Performance & Volunteerism

The Bank earned recognition in a number of areas in 2018 from the strength of our financial performance to the capabilities of our talented team. Among the highlights:

- Receiving, for the third straight year, the Financial Capability Innovation Award from EVERFI and Financial Capability Network for our digital financial education programs. These programs represent a tremendous opportunity for the communities we serve to improve their financial literacy, which wouldn't be possible without the passion and selflessness of our incredible team members.
- Being featured in the Western Bankers Association's "We Make an Impact" campaign, which praised the Bank for our support of SCORE – a nonprofit organization providing free mentoring, education and seminars for businesses.
- Being ranked 46 out of 100 in the S&P Global Market Intelligence "Top Performing Community Banks of 2017 with \$1 billion to \$10 billion in Assets," based on financials for the year ended 2017.
- Achieving a "Super Premier" performance rating from The Findley Reports – the highest of the three performance tiers recognized by the firm. This achievement is based upon the Bank's 2017 operating results.
- Earning the 5-Star Superior rating from Bauer Financial for all four quarters of 2018, a rating that denotes financial institutions that are among the nation's strongest and safest, operating above regulatory capital requirements.
- Received the 2018 Raymond James Community Bankers Cup award - ranking in the top 10% of community banks with assets between \$500 million and \$10 billion for the year ended 2018, demonstrating superior performance on measurements of financial performance and stability.
- Receiving a Silver Addy Award from the Fresno Advertising Federation in recognition of the Bank's excellent newspaper advertising creative.
- Being honored by The Business Journal as "Best Business Bank" for the fifth straight year in its 2018 Best of Central Valley Business Awards, and runner-up for "Best Company to Work For."

Serving Our Communities In So Many Ways

The Bank also continued our longstanding record of serving and supporting the communities we call home:

- Contributing both financially along with approximately 3,300 volunteer hours in leadership and support to worthwhile community nonprofit organizations, programs and causes.



Daniel J. Doyle
Chairman of the Board,
Central Valley Community Bancorp
Central Valley Community Bank

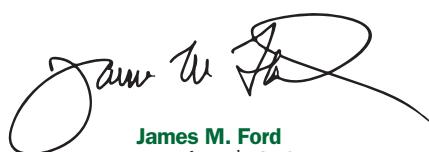
- Participating in the Better Business Bureau's Smarter Living Program, where Bank employees have provided financial education to over 1,400 Fresno County students.
- Participating in The Salvation Army's Angel Tree program, enabling team members and customers to provide gifts to nearly 500 children in need during the holiday season.
- Educating local businesses on ways to protect themselves and their customers from cybercriminals.
- Assisting Neighborhood Industries, a Fresno County nonprofit organization, with a \$25,000 AHEAD Program grant – the result of the Bank's submission of the grant application as a member of Federal Home Loan Bank San Francisco, the grant's sponsor. Neighborhood Industries provides workforce development efforts to help those seeking employment.
- Contributing, for the fifth consecutive year, to food banks throughout the Bank's territory to provide food for local families. In 2018, \$9,700 was provided to nine food banks. Over the past five years a total of \$35,200 has been donated, providing 316,000 pounds of food for those in need.

2019 Outlook

Looking ahead into 2019, our strategic plan includes the consolidation of the Bank's Rancho Cordova and Fair Oaks branches into a new Gold River location. As with the aforementioned 2018 consolidations, this will allow the Company's cost structure to further improve while providing greater opportunities to invest in technology – of increasing importance to banking consumers – as well as continued growth initiatives.

Recently, the Bank's executive management team restructured to align with strategic growth plans and encourage a more cross-functional client focus for both deposit and loan relationships. James Kim is now serving as Executive Vice President and Chief Operating Officer, and Teresa Gilio succeeds Kim as the new Executive Vice President and Chief Administrative Officer. Additionally, with the support from the entire team, our mission statement and core values were updated after many years to reflect the present-day culture of our Company. These guiding statements are proudly included in this report, on our website and on the walls of our branches, and are demonstrated daily by our team who are committed to the Company's success.

Heading into our 40th year in business, we believe delivering personalized financial solutions is more than just what differentiates Central Valley Community Bank from other financial institutions. It's the key to meeting the needs of our customers and ensuring that our communities thrive. By continuing to provide this key service in ways that are meaningful and beneficial, we will be able to reward our shareholders with a fair return, our team members with a secure future, and our customers with a strong, stable bank they can count on today... and tomorrow.



James M. Ford
President & CEO,
Central Valley Community Bancorp
Central Valley Community Bank



Board of Directors

Investing In Relationships



Daniel J. Doyle
*Chairman of the Board,
Central Valley Community Bancorp
Central Valley Community Bank*



James M. Ford
*President and CEO,
Central Valley Community Bancorp
Central Valley Community Bank*



Daniel N. Cunningham
*Lead Independent Director,
Central Valley Community Bancorp
Central Valley Community Bank
Director, Quinn Group Inc.*



Steven D. McDonald
*Secretary of the Board,
Central Valley Community Bancorp
Central Valley Community Bank
President, McDonald Properties, Inc.*



William S. Smittcamp
*President and CEO,
Wawona Frozen Foods*



Louis C. McMurray
*President,
Charles McMurray Co.*



Edwin S. Darden, Jr.
*Principal Emeritus,
Darden Architects, Inc.*



F.T. "Tommy" Elliott, IV
*Owner,
Wileman Bros. & Elliott, Inc.
Kaweah Container, Inc.*



Gary D. Gall
Retired Bank Executive



Karen A. Musson
*Marketing and Media,
Gar Tootelian, Inc.*



Robert J. Flatt
Retired Bank Executive



Making History, Together.

Our story is written by many hands, but with one vision: to help our customers and communities succeed. We are proud of our legacy of success, and just as proud that our story is still being written today.

A History Of Strength - A Heart Of Service

Central Valley Community Bank (the “Bank”), founded in 1979, is a California State chartered bank with deposit accounts insured by the Federal Deposit Insurance Corporation (FDIC). The Bank commenced operations on January 10, 1980, in Clovis, California, with 12 professional bankers and beginning assets of \$2,000,000.

Central Valley Community Bancorp (the “Company”) was established on November 15, 2000, as the holding company for Central Valley Community Bank and is registered as a bank holding company with the Board of Governors of the Federal Reserve System. The common stock of the Company trades on the NASDAQ stock exchange under the symbol “CVCY”.

The Bank operates full-service offices in 17 communities within the San Joaquin Valley and Greater Sacramento Region, and employs nearly 300 team members. Offices are located in Cameron Park, Clovis, Exeter, Folsom, Fresno, Gold River, Kerman, Lodi, Madera, Merced, Modesto, Oakhurst, Prather, Roseville, Stockton and Visalia. Additionally, the Bank operates Commercial, Real Estate, SBA and Agribusiness Lending Departments. Central Valley Investment Services are provided by Raymond James Financial, Inc.

With assets exceeding \$1.5 billion as of December 31, 2018, Central Valley Community Bank has grown into a well-capitalized institution, with a proven track record of financial strength, security and stability. The Company’s financial performance continues to receive industry acclaim and national recognition. Despite the Bank’s growth, it has remained true to its original “roots” – a commitment to its core values of teamwork, respect, accountability, integrity and leadership.

Central Valley Community Bank distinguishes itself from other financial institutions through its nearly four-decade track record of strength, security, client advocacy and the values that have guided the Bank since its opening. The Bank’s unique brand of personalized service has strategically grown throughout California’s San Joaquin Valley and Greater Sacramento Region. Guided by a hands-on Board of Directors and a seasoned Executive Management Team, the Bank continues to focus on personalized service, client referrals and employee satisfaction. Central Valley Community Bank’s strong foundation, concern for its team and training opportunities at all levels has afforded the ongoing recruitment and retention of high-quality employees.

Always On The Leading Edge Of Security & Convenience

Central Valley Community Bank maintains state-of-the-art data processing and information systems, and offers a complete line of innovative and competitive business and personal deposit and loan products. Through FDIC insurance, customer deposits for all insurable accounts are protected up to

\$250,000. For maximum convenience, personal and business services are available through Online Banking with Bill Pay, Mobile Banking, Mobile Deposit, CardValet and eStatements. Popmoney (person-to-person payments) is available for personal accounts. Businesses of all sizes benefit from custom-tailored Cash Management services through Business Online Banking. In addition, ATMs are located throughout the Bank’s territory, and clients are able to access ATMs nationwide for free through the MoneyPass network. BankLine provides 24-hour telephone banking and convenient banking hours are offered at the Bank’s offices.

A Proud Reputation Built On Personal Relationships

Central Valley Community Bank has built a reputation for superior banking service by offering personalized “relationship banking” for businesses, professionals and individuals. Serving the business community has always been a primary focus for the Bank, which continues to expand its commercial banking team to serve even more customers.

Central Valley Community Bank’s experienced banking professionals live and work in the local community, and have a deep understanding of the marketplace. As a result, the Bank has remained an active business lender and is proud to be a Preferred SBA Lender. Central Valley Community Bank received the honor of Cen Cal Business Group’s SBA Lender of the Year award, as the number one SBA 504 lender in the Central Valley for 2018.

At Central Valley Community Bank, you will find the secure lending power of a big bank plus the stable values and relationships of a community bank. From small manufacturers to large agribusiness organizations, healthcare companies to service industries and everything in between, Central Valley Community Bank is always ready to leverage its strength, experience and commitment to help businesses thrive – even in the toughest economic times – by offering tailored lending products.

Central Valley Community Bank is dedicated to providing outstanding value to customers by increasing and enhancing its products and services, while emphasizing needs-based consulting within the branch environment. Serving both new and long-time clients continues to be an important factor in the Bank’s growth, as demonstrated in ongoing customer referrals. Dependable values and security are important to banking customers, and the Bank is well-positioned to provide them with an ongoing emphasis on privacy, safety and convenience.

Supporting Our Communities In So Many Ways

Focused on investing in the communities it serves, the Bank annually supports a wide variety of organizations with financial donations and the talents and energy of its people. Additionally, Bank management serves in leadership positions for civic and philanthropic organizations, as well as industry groups at the state and national levels. Providing leadership- by-example sets the pace for the entire team who are committed to improving and strengthening the quality of life in the communities where they live, work and raise their families. This is evidenced by The Business Journal’s “Best of Central Valley Business Awards” where the Bank was honored for the fifth consecutive year as “Best Business Bank” and was first runner-up in the “Best Company to Work For” category in the four-county Central Valley.

A Firm Foundation For Building A Strong Future

Thanks to the vision of the Company’s leadership, as well as its Board of Directors, the Bank has grown steadily and sensibly for nearly four decades, keeping pace with the needs of its customers and the communities it serves, all while retaining the local values that formed the Bank’s firm foundation. **4**

Diverse in Talent. United in Mission.



Mission Statement

We provide personalized financial solutions that guide businesses and communities to succeed and thrive.

Core Values

Teamwork, Respect, Accountability,
Integrity and Leadership



Central Valley Community Bank Executive Management

From Left to Right: David A. Kinross, Patrick J. Carman, Dawn M. Cagle, James M. Ford, Gary D. Quisenberry, Lydia E. Shaw, Teresa Gilio and James J. Kim

Holding Company & Bank Officers

James M. Ford
President and CEO

Patrick J. Carman
*Executive Vice President,
Chief Credit Officer*

David A. Kinross
*Executive Vice President,
Chief Financial Officer*

Bank Executive Management

James J. Kim
*Executive Vice President,
Chief Operating Officer*

Gary D. Quisenberry
*Executive Vice President,
Commercial and Business Banking*

Lydia E. Shaw
*Executive Vice President,
Community Banking*

Teresa Gilio
*Executive Vice President,
Chief Administrative Officer*

Dawn M. Cagle
*Senior Vice President,
Human Resources*

Independent Auditors

Crowe LLP,
Sacramento, CA

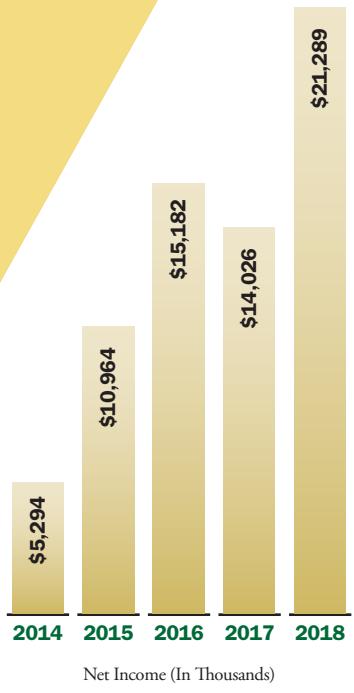
Counsel

Buchalter, A Professional Corporation,
Sacramento, CA

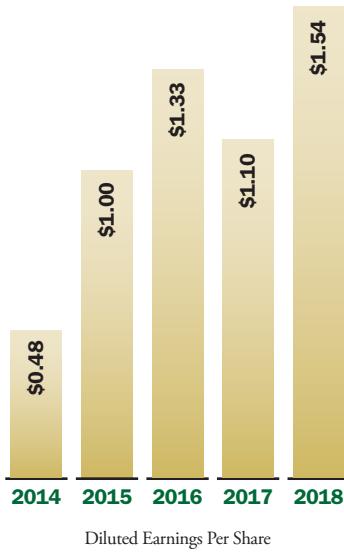


Trend Analysis

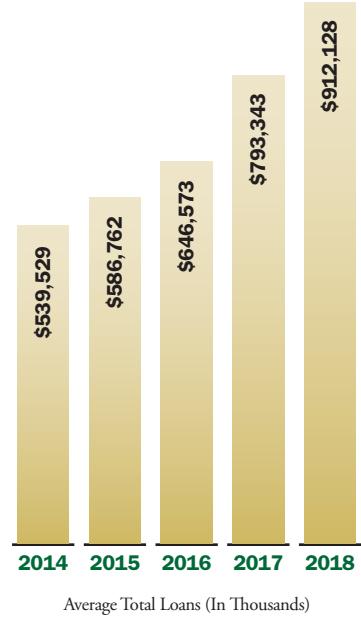
Central Valley Community Bancorp



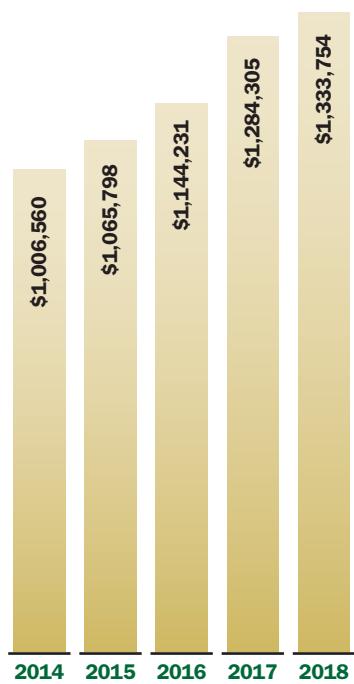
Net Income (In Thousands)



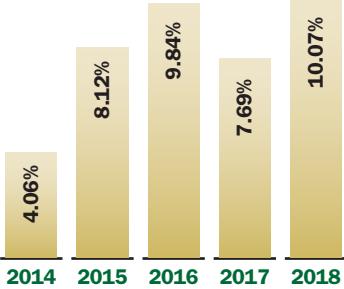
Diluted Earnings Per Share



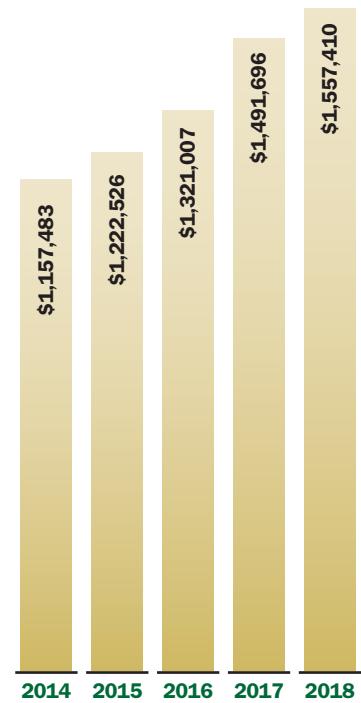
Average Total Loans (In Thousands)



Average Total Deposits (In Thousands)



Return on Shareholders' Equity



Average Total Assets (In Thousands)

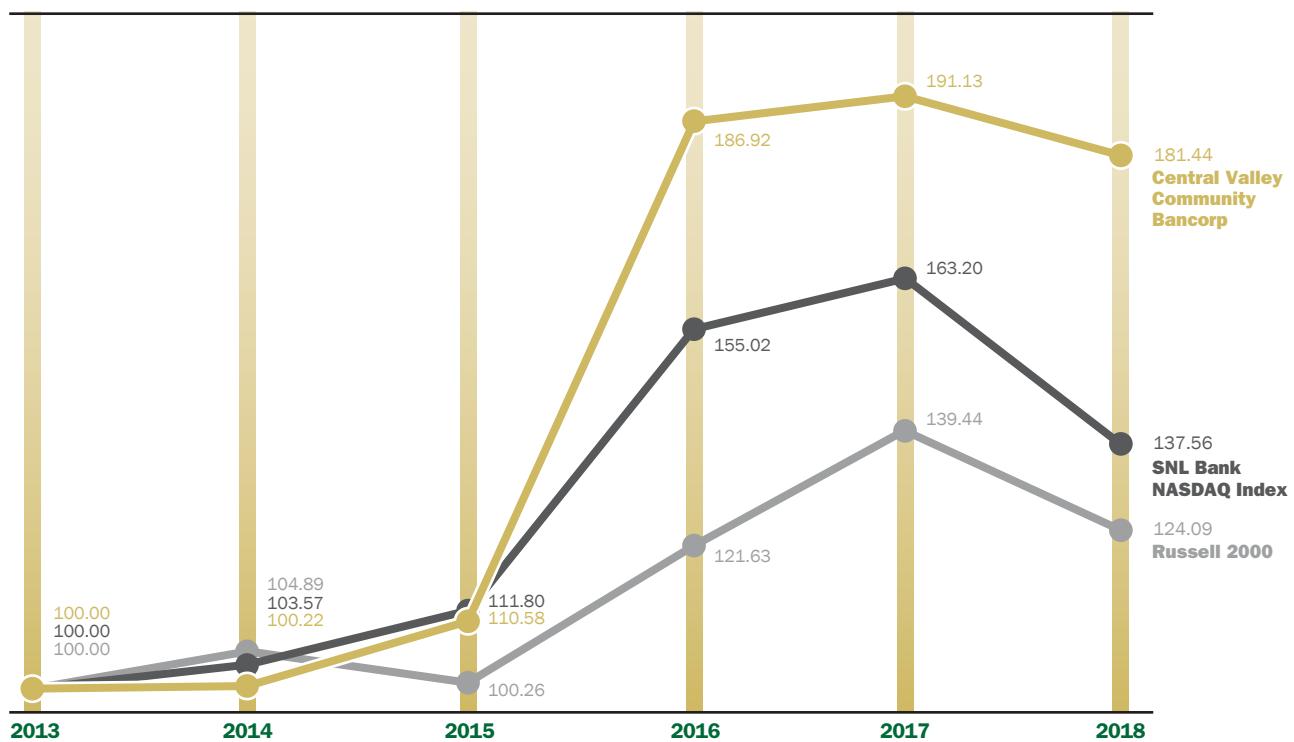


Comparative Stock Price Performance

Central Valley Community Bancorp

Total Return Performance

Index Value



Note: The graph above shows the cumulative total shareholder return on Central Valley Community Bancorp common stock compared to the cumulative total returns for the Russell 2000 Index and the SNL Bank NASDAQ Index, measured as of the last trading day of each year shown. The graph assumes an investment of \$100 on December 31, 2013 and reinvestment of dividends on the date of payment without commissions. The performance graph represents past performance and should not be considered to be an indication of future stock performance.

The stock price performance shown above should not be indicative of potential future stock price performance.

Source: S&P Global Market Intelligence
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CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY

Consolidated Balance Sheets

December 31, 2018 and 2017 (In thousands, except share amounts)

<u>ASSETS</u>	<u>2018</u>	<u>2017</u>
Cash and due from banks	\$ 24,954	\$ 38,286
Interest-earning deposits in other banks	6,725	62,080
Federal funds sold	48	17
Total cash and cash equivalents	31,727	100,383
Available-for-sale debt securities	463,905	535,281
Equity securities	7,254	7,423
Loans, less allowance for credit losses of \$9,104 at December 31, 2018 and \$8,778 at December 31, 2017	909,591	891,901
Bank premises and equipment, net	8,484	9,398
Bank owned life insurance	28,502	27,807
Federal Home Loan Bank stock	6,843	6,843
Goodwill	53,777	53,777
Core deposit intangibles	2,572	3,027
Accrued interest receivable and other assets	25,181	25,815
Total assets	<u>\$ 1,537,836</u>	<u>\$ 1,661,655</u>
 <u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>		
Deposits:		
Non-interest bearing	\$ 550,657	\$ 585,039
Interest bearing	<u>731,641</u>	<u>840,648</u>
Total deposits	1,282,298	1,425,687
Short-term borrowings	10,000	-
Junior subordinated deferrable interest debentures	5,155	5,155
Accrued interest payable and other liabilities	<u>20,645</u>	<u>21,254</u>
Total liabilities	1,318,098	1,452,096
Commitments and contingencies (Note 12)		
Shareholders' equity:		
Preferred stock, no par value; 10,000,000 shares authorized, none issued and outstanding	-	-
Common stock, no par value; 80,000,000 shares authorized; issued and outstanding: 13,754,965 at December 31, 2018 and 13,696,722 at December 31, 2017	103,851	103,314
Retained earnings	120,294	103,419
Accumulated other comprehensive (loss) income, net of tax	<u>(4,407)</u>	<u>2,826</u>
Total shareholders' equity	219,738	209,559
Total liabilities and shareholders' equity	<u>\$ 1,537,836</u>	<u>\$ 1,661,655</u>

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

CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY

Consolidated Statements

of Income

For the Years Ended December 31, 2018, 2017, and 2016 (In thousands, except per share amounts)

	2018	2017	2016
Interest income:			
Interest and fees on loans	\$ 49,936	\$ 43,534	\$ 34,051
Interest on deposits in other banks	459	424	289
Interest and dividends on investment securities:			
Taxable	10,254	6,526	5,876
Exempt from Federal income taxes	3,538	6,892	6,460
Total interest income	64,187	57,376	46,676
Interest expense:			
Interest on deposits	1,153	969	975
Interest on junior subordinated deferrable interest debentures	199	147	121
Other	132	21	-
Total interest expense	1,484	1,137	1,096
Net interest income before provision for credit losses	62,703	56,239	45,580
Provision for (Reversal of) credit losses	50	(1,150)	(5,850)
Net interest income after provision for credit losses	62,653	57,389	51,430
Non-interest income:			
Service charges	2,986	3,053	2,849
Appreciation in cash surrender value of bank owned life insurance	695	621	558
Interchange fees	1,462	1,458	1,228
Loan placement fees	708	706	1,083
Net realized gain on sale of credit card portfolio	462	-	-
Net realized gains on sales and calls of investment securities	1,314	2,802	1,920
Other-than-temporary impairment loss on investment securities	-	-	(136)
Federal Home Loan Bank dividends	590	443	630
Other income	2,107	1,753	1,459
Total non-interest income	10,324	10,836	9,591
Non-interest expenses:			
Salaries and employee benefits	26,221	24,738	21,881
Occupancy and equipment	5,972	5,186	4,754
Regulatory assessments	619	652	642
Data processing expense	1,666	1,740	1,707
Professional services	1,475	1,509	1,258
ATM/Debit card expenses	739	750	633
Information technology	1,113	818	531
Directors' expenses	465	597	530
Advertising	758	638	576
Internet banking expenses	732	705	678
Acquisition and integration expenses	217	1,828	1,782
Amortization of core deposit intangibles	455	234	149
Other expense	4,636	5,011	3,801
Total non-interest expenses	45,068	44,406	38,922
Income before provision for income taxes	27,909	23,819	22,099
Provision for income taxes	6,620	9,793	6,917
Net income	\$ 21,289	\$ 14,026	\$ 15,182
Basic earnings per common share	\$ 1.55	\$ 1.12	\$ 1.34
Diluted earnings per common share	\$ 1.54	\$ 1.10	\$ 1.33
Cash dividends per common share	\$ 0.31	\$ 0.24	\$ 0.24

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

CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY

Consolidated Statements

of Comprehensive Income

For the Years Ended December 31, 2018, 2017, and 2016 (In thousands)

	2018	2017	2016
NET INCOME	\$ 21,289	\$ 14,026	\$ 15,182
Other Comprehensive Income (Loss):			
Unrealized gains (losses) on securities:			
Unrealized holdings (losses) gains arising during the period	(9,159)	7,705	(9,924)
Less: reclassification for net gains included in net income	1,314	2,802	1,224
Less: reclassification for other-than-temporary impairment loss included in net income	-	-	(136)
Transfer of investment securities from held-to-maturity to available-for-sale	-	-	2,647
Amortization of net unrealized gains transferred	-	-	(64)
Other comprehensive (loss) income, before tax	(10,473)	4,903	(8,429)
Tax benefit (expense) related to items of other comprehensive income	3,096	(2,062)	3,451
Total other comprehensive (loss) income	(7,377)	2,841	(4,978)
Comprehensive income	\$ 13,912	\$ 16,867	\$ 10,204

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

CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY

Consolidated Statements

of Changes in Shareholders' Equity

For the Years Ended December 31, 2018, 2017, and 2016 (In thousands, except share amounts)

	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss) (Net of Taxes)	Total Shareholders' Equity
	Shares	Amount			
Balance, January 1, 2016	10,996,773	\$ 54,424	\$ 80,437	\$ 4,462	\$ 139,323
Net income	-	-	15,182	-	15,182
Other comprehensive loss	-	-	-	(4,978)	(4,978)
Restricted stock granted, forfeited and related tax benefit	52,911	(2)	-	-	(2)
Cash dividend (\$0.24 per common share)	-	-	(2,715)	-	(2,715)
Stock issued for acquisition	1,058,851	16,678	-	-	16,678
Stock-based compensation expense	-	284	-	-	284
Stock options exercised and related tax benefit	35,280	261	-	-	261
Balance, December 31, 2016	12,143,815	71,645	92,904	(516)	164,033
Net income	-	-	14,026	-	14,026
Other comprehensive income	-	-	-	2,841	2,841
Reclassification associated with the adoption of ASU 2018-02	-	-	(501)	501	-
Stock issued under employee stock purchase plan	2,441	45	-	-	45
Restricted stock granted, (forfeited) and related tax benefit	(2,360)	-	-	-	-
Stock issued for acquisition	1,276,888	28,405	-	-	28,405
Stock-based compensation expense	-	384	-	-	384
Cash dividend (\$0.24 per common share)	-	-	(3,010)	-	(3,010)
Stock options exercised and related tax benefit	275,938	2,835	-	-	2,835
Balance, December 31, 2017	13,696,722	103,314	103,419	2,826	209,559
Cumulative effect of equity securities gains reclassified	-	-	(144)	144	-
Adjusted Balance, January 1, 2018	13,696,722	103,314	103,275	2,970	209,559
Net income	-	-	21,289	-	21,289
Other comprehensive loss	-	-	-	(7,377)	(7,377)
Restricted stock granted, (forfeited) and related tax benefit	20,494	-	-	-	-
Stock issued under employee stock purchase plan	11,581	211	-	-	211
Stock-based compensation expense	-	482	-	-	482
Cash dividend (\$0.31 per common share)	-	-	(4,270)	-	(4,270)
Stock options exercised and related tax benefit	74,030	738	-	-	738
Repurchase and retirement of common stock	(47,862)	(894)	-	-	(894)
Balance, December 31, 2018	<u>13,754,965</u>	<u>\$ 103,851</u>	<u>\$ 120,294</u>	<u>\$ (4,407)</u>	<u>\$ 219,738</u>

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

CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY

Consolidated Statements

of Cash Flows

For the Years Ended December 31, 2018, 2017, and 2016 (In thousands)

	2018	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 21,289	\$ 14,026	\$ 15,182
Adjustments to reconcile net income to net cash provided by operating activities:			
Net decrease (increase) in deferred loan costs	233	(92)	(851)
Depreciation	1,703	1,429	1,320
Accretion	(898)	(766)	(1,142)
Amortization	6,457	8,519	7,912
Stock-based compensation	482	384	284
Excess tax benefit from exercise of stock options	-	-	(30)
Provision for (reversal of) credit losses	50	(1,150)	(5,850)
Other than temporary impairment losses on investment securities	-	-	136
Net realized gains on sales and calls of available-for-sale investment securities	(1,314)	(2,802)	(1,224)
Net realized gains on sales or calls of held-to-maturity investment securities	-	-	(696)
Net loss on sale and disposal of equipment	2	-	4
Write down of equity investments	42	-	-
Increase in bank owned life insurance, net of expenses	(695)	(621)	(558)
Net gain on sale of credit card portfolio	(462)	-	-
Net gain on bank owned life insurance	-	-	(190)
Net decrease (increase) in accrued interest receivable and other assets	3,218	(2,263)	(4,711)
Net (decrease) increase in accrued interest payable and other liabilities	(599)	1,370	821
Benefit for deferred income taxes	403	7,184	2,592
Net cash provided by operating activities	<u>29,911</u>	<u>25,218</u>	<u>12,999</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Net cash and cash equivalents acquired in acquisitions	-	26,279	13,241
Purchases of available-for-sale investment securities	(225,970)	(226,740)	(278,664)
Proceeds from sales or calls of available-for-sale investment securities	246,824	228,405	167,163
Proceeds from sales or calls of held-to-maturity investment securities	-	-	9,257
Proceeds from maturity and principal repayment of available-for-sale investment securities	36,495	44,956	50,531
Proceeds from sale of credit card portfolio	2,954	-	-
Net increase in loans	(20,477)	(25,542)	(29,930)
Purchases of premises and equipment	(791)	(859)	(861)
Proceeds from bank owned life insurance	-	-	928
Proceeds from sale of premises and equipment	-	-	7
Net cash provided by (used in) investing activities	<u>39,035</u>	<u>46,499</u>	<u>(68,328)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net (decrease) increase in demand, interest-bearing and savings deposits	(112,134)	45,672	26,372
Net decrease in time deposits	(31,253)	(48,044)	(25,038)
Proceeds from short-term borrowings from Federal Home Loan Bank	568,500	-	-
Repayments of short-term borrowings to Federal Home Loan Bank	(558,500)	(7,000)	-
Proceeds of borrowings from other financial institutions	19,705	-	400
Repayments of borrowings from other financial institutions	(19,705)	(400)	-
Purchase and retirement of common stock	(894)	-	-
Proceeds from stock issued under employee stock purchase plan	211	45	-
Proceeds from exercise of stock options	738	2,835	231
Excess tax benefit from exercise of stock options	-	-	30
Cash dividend payments on common stock	(4,270)	(3,010)	(2,715)
Net cash used in financing activities	<u>(137,602)</u>	<u>(9,902)</u>	<u>(720)</u>
(Decrease) increase in cash and cash equivalents	<u>(68,656)</u>	<u>61,815</u>	<u>(56,049)</u>
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR			
CASH AND CASH EQUIVALENTS AT END OF YEAR			
	<u>\$ 31,727</u>	<u>\$ 100,383</u>	<u>\$ 38,568</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest	\$ 1,460	\$ 1,171	\$ 1,053
Income taxes	\$ 2,700	\$ 4,720	\$ 5,840
Non-cash investing and financing activities:			
Transfer of securities from held-to-maturity to available-for-sale	\$ -	\$ -	\$ 23,131
Unrealized gain on transfer of securities from held-to-maturity to available-for-sale	\$ -	\$ -	\$ 526
Transfer of loans to other assets	\$ -	\$ -	\$ 363
Common stock issued in acquisitions	\$ -	\$ 28,405	\$ 16,678

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

Notes to Consolidated Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General - Central Valley Community Bancorp (the "Company") was incorporated on February 7, 2000 and subsequently obtained approval from the Board of Governors of the Federal Reserve System to be a bank holding company in connection with its acquisition of Central Valley Community Bank (the "Bank"). The Company became the sole shareholder of the Bank on November 15, 2000 in a statutory merger, pursuant to which each outstanding share of the Bank's common stock was exchanged for one share of common stock of the Company.

Service 1st Capital Trust I (the Trust) is a business trust formed by Service 1st for the sole purpose of issuing trust preferred securities. The Company succeeded to all the rights and obligations of Service 1st in connection with the acquisition of Service 1st. The Trust is a wholly-owned subsidiary of the Company.

The Bank operates 21 full service offices throughout California's San Joaquin Valley and Greater Sacramento Region. The Bank's primary source of revenue is providing loans to customers who are predominately small and middle-market businesses and individuals.

The deposits of the Bank are insured by the Federal Deposit Insurance Corporation (FDIC) up to applicable legal limits. Depositors' accounts at an insured depository institution, including all non-interest bearing transactions accounts, will be insured by the FDIC up to the standard maximum deposit insurance amount of \$250,000 for each deposit insurance ownership category.

The accounting and reporting policies of the Company and the Bank conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Management has determined that because all of the banking products and services offered by the Company are available in each branch of the Bank, all branches are located within the same economic environment and management does not allocate resources based on the performance of different lending or transaction activities, it is appropriate to aggregate the Bank branches and report them as a single operating segment. No customer accounts for more than 10 percent of revenues for the Company or the Bank.

Principles of Consolidation - The consolidated financial statements include the accounts of the Company and the consolidated accounts of its wholly-owned subsidiary, the Bank. Intercompany transactions and balances are eliminated in consolidation.

For financial reporting purposes, Service 1st Capital Trust I, is a wholly-owned subsidiary acquired in the merger of Service 1st Bancorp and formed for the exclusive purpose of issuing trust preferred securities. The Company is not considered the primary beneficiary of this trust (variable interest entity), therefore the trust is not consolidated in the Company's financial statements, but rather the subordinated debentures are shown as a liability on the Company's consolidated financial statements. The Company's investment in the common stock of the Trust is included in accrued interest receivable and other assets on the consolidated balance sheet.

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

These estimates result in judgments regarding the carrying values of assets and liabilities when these values are not readily available from other sources, as well as assessing and identifying the accounting treatments of contingencies and commitments. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates under different assumptions.

Cash and Cash Equivalents - For the purpose of the statement of cash flows, cash, due from banks with maturities less than 90 days, interest-earning deposits in other banks, and Federal funds sold are considered to be cash equivalents. Generally, Federal funds are sold and purchased for one-day periods. Net cash flows are reported for customer loan and deposit transactions, interest-bearing deposits in other banks, and Federal funds purchased.

Investment Securities - Investments are classified into the following categories:

- Available-for-sale securities, reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders' equity.

- Held-to-maturity securities, which management has the positive intent and ability to hold to maturity, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums.

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value in the period which the transfer occurs. During the year ended December 31, 2018, there were no transfers between categories.

Gains or losses on the sale of investment securities are computed on the specific identification method. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums. Premiums and discounts on securities are amortized or accreted on the level yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated.

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

Loans - All loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at principal balances outstanding net of deferred loan fees and costs, and the allowance for credit losses. Interest is accrued daily based upon outstanding loan principal balances. However, when a loan becomes impaired and the future collectability of interest and principal is in serious doubt, the loan is placed on nonaccrual status and the accrual of interest income is suspended. Any loan delinquent 90 days or more is automatically placed on nonaccrual status. Any interest accrued but unpaid is charged against income. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectability of principal is not in doubt, are applied first to principal until fully collected and then to interest.

Interest income on loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Consumer and credit card loans are typically charged off no later than 90 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. A loan placed on non-accrual status may be restored to accrual status when principal and interest are no longer past due and unpaid, or the loan otherwise becomes both well secured and in the process of collection. When a loan is brought current, the Company must also have reasonable assurance that the obligor has the ability to meet all contractual obligations in the future, that the loan will be repaid within a reasonable period of time, and that a minimum of six months of satisfactory repayment performance has occurred.

Substantially all loan origination fees, commitment fees, direct loan origination costs and purchase premiums and discounts on loans are deferred and recognized as an adjustment of yield, and amortized to interest income over the contractual term of the loan. The unamortized balance of deferred fees and costs is reported as a component of net loans.

Notes to Consolidated Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Acquired loans and Leases - Loans and leases acquired through purchase or through a business combination are recorded at their fair value at the acquisition date. Credit discounts are included in the determination of fair value; therefore, an allowance for loan and lease losses is not recorded at the acquisition date. Should the Company's allowance for credit losses methodology indicate that the credit discount associated with acquired, non-purchased credit impaired loans, is no longer sufficient to cover probable losses inherent in those loans, the Company will establish an allowance for those loans through a charge to provision for credit losses. At the time of an acquisition, we evaluate loans to determine if they are purchase credit impaired loans. Purchased credit impaired loans are those acquired loans with evidence of credit deterioration for which collection of all contractual payments was not considered probable at the date of acquisition. This determination is made by considering past due and/or nonaccrual status, prior designation of a troubled debt restructuring, or other factors that may suggest we will not be able to collect all contractual payments. Purchased credit impaired loans are initially recorded at fair value with the difference between fair value and estimated future cash flows accreted over the expected cash flow period as income only to the extent we can reasonably estimate the timing and amount of future cash flows. In this case, these loans would be classified as accruing. In the event we are unable to reasonably estimate the timing and amount of future cash flows, or if the loan is acquired primarily for the rewards of ownership of the underlying collateral, the loan is classified as non-accrual. An acquired loan previously classified by the seller as a troubled debt restructuring is no longer classified as such at the date of acquisition. Past due status is reported based on contractual payment status.

All loans not otherwise classified as purchase credit impaired are recorded at fair value with the discount to contractual value accreted over the life of the loan.

Allowance for Credit Losses - The allowance for credit losses (the "allowance") is a valuation allowance for probable incurred credit losses in the Company's loan portfolio. The allowance is established through a provision for credit losses which is charged to expense. Additions to the allowance are made to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired loans and general reserves for inherent losses related to loans that are not impaired.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Loans determined to be impaired are individually evaluated for impairment. When a loan is impaired, the Company measures impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, it may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to come solely from the sale or operation of underlying collateral.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Company for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above.

When determining the allowance for loan losses on acquired loans, we bifurcate the allowance between legacy loans and acquired loans. Loans remain designated as acquired until either (i) loan is renewed or (ii) loan is substantially modified whereby modification results in a new loan. When determining the

allowance on acquired loans, the Company estimates probable incurred credit losses as compared to the Company's recorded investment, with the recorded investment being net of any unaccreted discounts from the acquisition.

The determination of the general reserve for loans that are not impaired is based on estimates made by management, including but not limited to, consideration of a simple average of historical losses by portfolio segment (and in certain cases peer loss data) over the most recent 20 quarters, and qualitative factors including economic trends in the Company's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio taken as a whole.

The Company segregates the allowance by portfolio segment. These portfolio segments include commercial, real estate, and consumer loans. The relative significance of risk considerations vary by portfolio segment. For commercial and real estate loans, the primary risk consideration is a borrower's ability to generate sufficient cash flows to repay their loan. Secondary considerations include the creditworthiness of guarantors and the valuation of collateral. In addition to the creditworthiness of a borrower, the type and location of real estate collateral is an important risk factor for real estate loans. The primary risk considerations for consumer loans are a borrower's personal cash flow and liquidity, as well as collateral value. The allowance for credit losses attributable to each portfolio segment, which includes both impaired loans and loans that are not impaired, is combined to determine the Company's overall allowance, which is included on the consolidated balance sheet.

Commercial:

Commercial and industrial - Commercial and industrial loans are generally underwritten to existing cash flows of operating businesses. Additionally, economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Past due payments may indicate the borrower's capacity to repay their obligations may be deteriorating.

Agricultural production - Loans secured by crop production and livestock are especially vulnerable to two risk factors that are largely outside the control of Company and borrowers: commodity prices and weather conditions.

Real Estate:

Owner-occupied commercial real estate - Real estate collateral secured by commercial or professional properties with repayment arising from the owner's business cash flows. To meet this classification, the owner's operation must occupy no less than 50% of the real estate held. Financial profitability and capacity to meet the cyclical nature of the industry and related real estate market over a significant timeframe is essential.

Real estate construction and other land loans - Land and construction loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within specified costs and time lines. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

Agricultural real estate - Agricultural loans secured by real estate generally possess a higher inherent risk of loss caused by changes in concentration of permanent plantings, government subsidies, and the value of the U.S. dollar affecting the export of commodities.

Investor commercial real estate - Investor commercial real estate loans generally possess a higher inherent risk of loss than other real estate portfolio segments, except land and construction loans. Adverse economic developments or an overbuilt market impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flows to service debt obligations.

Notes to Consolidated Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Other real estate - Primarily loans secured by agricultural real estate for development and production of permanent plantings that have not reached maximum yields. Also real estate loans where agricultural vertical integration exists in packing and shipping of commodities. Risk is primarily based on the liquidity of the borrower to sustain payment during the development period.

Consumer:

Equity loans and lines of credit - The degree of risk in residential real estate lending depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than other real estate portfolio segments. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends may indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Installment and other consumer loans - An installment loan portfolio is usually comprised of a large number of small loans scheduled to be amortized over a specific period. Most installment loans are made directly for consumer purchases. Other consumer loans include other open ended unsecured consumer loans. Open ended unsecured loans generally have a higher rate of default than all other portfolio segments and are also impacted by weak economic conditions and trends. Open ended unsecured loans in homogeneous loan portfolio segments are not evaluated for specific impairment.

Although management believes the allowance to be adequate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Company's primary regulators, the FDIC and California Department of Business Oversight, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgments about information available at the time of their examinations.

Risk Rating - The Company assigns a risk rating to all loans, and periodically performs detailed reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. The most recent review of risk rating was completed in December 2018. These risk ratings are also subject to examination by independent specialists engaged by the Company, and the Company's regulators. During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into five major categories, defined as follows:

Pass - A pass loan is a strong credit with no existing or known potential weaknesses deserving of management's close attention.

Special Mention - A special mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Company's credit position at some future date. Special Mention loans are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

Substandard - A substandard loan is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well-defined weaknesses include a project's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time, or the project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful - Loans classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral, and refinancing plans. Doubtful classification is considered temporary and short term.

Loss - Loans classified as loss are considered uncollectible and charged off immediately.

The general reserve component of the allowance for credit losses also consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) inherent credit risk, (2) historical losses and (3) other qualitative factors including economic trends in the Company's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio taken as a whole. Inherent credit risk and qualitative reserve factors are inherently subjective and are driven by the repayment risk associated with each class of loans.

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

The Bank evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

Federal Home Loan Bank (FHLB) Stock - The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Investments in Low Income Housing Tax Credit Funds - The Bank has invested in limited partnerships that were formed to develop and operate affordable housing projects for low or moderate income tenants throughout California. Our ownership in each limited partnership is less than two percent. In accordance with ASU No. 2014-01, *Investments—Equity Method and Joint Ventures* (Topic 323), we elected to account for the investments in qualified affordable housing tax credit funds using the proportional amortization method. Under the proportional amortization method, the initial cost of the investment is amortized in proportion to the tax credits and other tax benefits received and the net investment performance is recognized as part of income tax expense (benefit). Each of the partnerships must meet the regulatory minimum requirements for affordable housing for a minimum 15-year compliance period to fully utilize the tax credits. If the partnerships cease to qualify during the compliance period, the credit may be denied for any period in which the project is not in compliance and a portion of the credit previously taken is subject to recapture with interest. The Company's investment in Low Income Housing Tax Credit Funds is reported in other assets on the consolidated balance sheet.

Other Real Estate Owned - Other real estate owned (OREO) is comprised of property acquired through foreclosure proceedings or acceptance of deeds-in-lieu of foreclosure. Losses recognized at the time of acquiring property in full or partial satisfaction of debt are charged against the allowance for credit losses. OREO, when acquired, is initially recorded at fair value less estimated disposition costs, establishing a new cost basis. Fair value of OREO is generally based on an independent appraisal of the property. Subsequent to initial measurement, OREO

Notes to Consolidated Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

is carried at the lower of the recorded investment or fair value less disposition costs. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through noninterest expense. Revenues and expenses associated with OREO are reported as a component of noninterest expense when incurred.

Foreclosed Assets - Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through operations. Operating costs after acquisition are expensed. Gains and losses on disposition are included in noninterest expense. The carrying value of foreclosed assets was \$0 at December 31, 2018 and \$70,000 at December 31, 2017, and is included in other assets on the consolidated balance sheets.

Bank Owned Life Insurance - The Company has purchased life insurance policies on certain key executives. Company owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Business Combinations - The Company accounts for acquisitions of businesses using the acquisition method of accounting. Under the acquisition method, assets and liabilities assumed are recorded at their estimated fair values at the date of acquisition. Management utilizes various valuation techniques included discounted cash flow analyses to determine these fair values. Any excess of the purchase price over amounts allocated to the acquired assets, including identifiable intangible assets, and liabilities assumed is recorded as goodwill.

Goodwill - Business combinations involving the Bank's acquisition of the equity interests or net assets of another enterprise give rise to goodwill. Total goodwill at December 31, 2018 and 2017 represents the excess of the purchase price of acquired businesses over the net fair value of assets, including identified intangible assets, acquired and liabilities assumed in the transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Bank's ability to generate net earnings after the acquisitions. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed at least annually for impairment.

The Company has selected September 30 as the date to perform the annual impairment test. Management assessed qualitative factors including performance trends and noted no factors indicating goodwill impairment. Goodwill is also tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the Company below its carrying amount. No such events or circumstances arose during the fourth quarter of 2018, so goodwill was not required to be retested. Goodwill is the only intangible asset with an indefinite life on our balance sheet.

Intangible Assets - The intangible assets at December 31, 2018 represent the estimated fair value of the core deposit relationships acquired in business combinations. Core deposit intangibles are being amortized using the straight-line method over an estimated life of five to ten years from the date of acquisition. Management evaluates the remaining useful lives quarterly to determine whether events or circumstances warrant a revision to the remaining periods of amortization. Based on the evaluation, no changes to the remaining useful lives was required. Management performed an annual impairment test on core deposit intangibles as of September 30, 2018 and determined no impairment was necessary. Core deposit intangibles are also tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value below its carrying amount. No such events or circumstances arose during the fourth quarter of 2018, so core deposit intangibles were not required to be retested.

Loan Commitments and Related Financial Instruments - Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount of these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

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

Income tax expense represents the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. On the balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax assets will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed.

Accounting for Uncertainty in Income Taxes - The Company uses a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. A tax position is recognized as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the more likely than not test, no tax benefit is recorded.

Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the consolidated statement of income.

Retirement Plans - Employee 401(k) plan expense is the amount of employer matching contributions. Profit sharing plan expense is the amount of employer contributions. Contributions to the profit sharing plan are determined at the discretion of the Board of Directors. Deferred compensation and supplemental retirement plan expense is allocated over years of service.

Earnings Per Common Share - Basic earnings per common share (EPS), which excludes dilution, is computed by dividing income available to common shareholders (net income after deducting dividends, if any, on preferred stock and accretion of discount) by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options or warrants, result in the issuance of common stock which shares in the earnings of the Company. All data with respect to computing earnings per share is retroactively adjusted to reflect stock dividends and splits and the treasury stock method is applied to determine the dilutive effect of stock options in computing diluted EPS.

Comprehensive Income - Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale which are also recognized as separate components of equity.

Loss Contingencies - Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are such matters that will have a material effect on the financial statements.

Restrictions on Cash - Cash on hand or on deposit with the Federal Reserve Bank was required to meet regulatory reserve and clearing requirements.

Share-Based Compensation - Compensation cost is recognized for stock options and restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes-Merton model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards. Additionally, the compensation expense for the Company's employee stock ownership plan is based on the market price of the shares as they are committed to be released to participant accounts. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting,

Notes to Consolidated Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Dividend Restriction - Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the Company or by the Company to shareholders.

Fair Value of Financial Instruments - Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in *Note 3*. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

Recently Issued Accounting Standards:

FASB Accounting Standards Update (ASU) 2014-09 - Revenue from Contracts with Customers (Topic 606): *Revenue from Contracts with Customers* was issued in May 2014. This ASU is the result of a joint project initiated by the FASB and the International Accounting Standards Board (IASB) to clarify the principles for recognizing revenue, and to develop common revenue standards and disclosure requirements that would: (1) remove inconsistencies and weaknesses in revenue requirements; (2) provide a more robust framework for addressing revenue issues; (3) improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; (4) provide more useful information to users of financial statements through improved disclosures; and (5) simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. The guidance affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets. The core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides steps to follow to achieve the core principle. An entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative information is required with regard to contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This ASU is effective for annual reporting periods beginning after December 15, 2017, including interim periods therein, with early adoption permitted for reporting periods beginning after December 15, 2016. The Company adopted ASU 2014-09 on January 1, 2018 utilizing the modified retrospective approach. Since the guidance does not apply to revenue associated with financial instruments such as loans and investments, which are accounted for under other provisions of GAAP, there was no impact to interest income, our largest component of income. The Company adopted this ASU effective January 1, 2018 and it did not have a material impact on the Company's consolidated financial position, cash flows or results of operations. No cumulative adjustment was required upon adoption.

The Company performed an overall assessment of revenue streams potentially affected by the ASU, including certain deposit related fees and interchange fees, to determine the potential impact of this guidance on our consolidated financial statements. Approximately 90% of our revenue, including all of our net interest income and a portion of our noninterest income, is out of scope of the guidance. The contracts that are in scope of the guidance are primarily related to service charges and fees on deposit accounts, debit card fees, ATM processing fees, and other service charges, commissions and fees. We have completed analyzing the individual contracts in scope and determined our revenue recognition practices within the scope of the ASU as described below did not change in any material regard upon adoption of the ASU.

Service Charges on Deposit Accounts: The Company earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. Account maintenance fees, which relate primarily to

monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance.

Merchant and Debit Card Fees: The Company earns interchange fees from cardholder transactions conducted through the payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

FASB Accounting Standards Update (ASU) 2016-01 - Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, was issued January 2016. The main provisions of the update are to eliminate the available-for-sale classification of accounting for equity securities and to adjust the fair value disclosures for financial instruments carried at amortized costs such that the disclosed fair values represent an exit price as opposed to an entry price. The provisions of this update will require that equity securities be carried at fair market value on the balance sheet and any periodic changes in value will be adjustments to the income statement. A practical expedient is provided for equity securities without a readily determinable fair value, such that these securities can be carried at cost less any impairment. ASU No. 2016-01 was effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The impact of adoption of this ASU by the Company was not material, but did result in a reclassification of an equity investment from securities available-for-sale to equity securities. The Company was required to adopt the ASU provisions on January 1, 2018, and for those equity securities with readily determinable fair values, the Company elected the modified retrospective transition approach with a cumulative effect adjustment to the balance sheet. The impact of the adoption of this accounting standard on the Company's consolidated financial statements will be subject to the price volatility of the equity investments. As a result of the adoption, \$144,000 of after-tax unrealized losses on equity securities were reclassified on January 1, 2018, from accumulated other comprehensive income to beginning retained earnings. In addition, the fair value disclosures for financial instruments in Note 3 are computed using an exit price notion as required by the ASU.

FASB Accounting Standards Update (ASU) 2016-02 - Leases—Overall (Subtopic 845), was issued February 2016. ASU 2016-02 will, among other things, require lessees to recognize a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and ASC Topic 606, "Revenue from Contracts with Customers." ASU 2016-02 will be effective for us on January 1, 2019 and initially required transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. In July 2018, the FASB issued ASU 2018-11, "Leases (Topic 842)—Targeted Improvements," which, among other things, provides an additional transition method that would allow entities to not apply the guidance in ASU 2016-02 in the comparative periods presented in the financial statements and instead recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. In December 2018, the FASB also issued ASU 2018-20, "Leases (Topic 842)—Narrow-Scope Improvements for Lessors," which provides for certain policy elections and changes lessor accounting for sales and similar taxes and certain lessor costs. As of January 1, 2019, the Company adopted ASU 2016-02 and has recorded a right-of-use asset and lease liability of approximately \$10 million on the balance sheet for its operating leases where it is a lessee. We elected to apply certain practical expeditives provided under ASU 2016-02 whereby we will not reassess(i) whether any expired or existing contracts are or contain leases, (ii) the lease classification for any expired or existing leases and (iii) initial direct costs for any existing leases. We also do not expect to apply the recognition requirements of ASU 2016-02 to any short-term leases (as defined by related accounting guidance). We expect to account for lease and non-lease components separately because such amounts are readily determinable under our lease contracts and because we expect this election will result in a lower impact on our balance sheet.

Notes to Consolidated Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

FASB Accounting Standards Update (ASU) 2016-13 - Measurement of Credit Losses on Financial Instruments (Subtopic 326): Financial Instruments—Credit Losses, commonly referred to as “CECL,” was issued June 2016. The provisions of the update eliminate the probable initial recognition threshold under current GAAP which requires reserves to be based on an incurred loss methodology. Under CECL, reserves required for financial assets measured at amortized cost will reflect an organization’s estimate of all expected credit losses over the contractual term of the financial asset and thereby require the use of reasonable and supportable forecasts to estimate future credit losses. Because CECL encompasses all financial assets carried at amortized cost, the requirement that reserves be established based on an organization’s reasonable and supportable estimate of expected credit losses extends to held to maturity (“HTM”) debt securities. Under the provisions of the update, credit losses recognized on available for sale (“AFS”) debt securities will be presented as an allowance as opposed to a write-down. In addition, CECL will modify the accounting for purchased loans, with credit deterioration since origination, so that reserves are established at the date of acquisition for purchased loans. Under current GAAP a purchased loan’s contractual balance is adjusted to fair value through a credit discount and no reserve is recorded on the purchased loan upon acquisition. Since under CECL reserves will be established for purchased loans at the time of acquisition, the accounting for purchased loans is made more comparable to the accounting for originated loans. Finally, increased disclosure requirements under CECL require organizations to present the currently required credit quality disclosures disaggregated by the year of origination or vintage. The FASB expects that the evaluation of underwriting standards and credit quality trends by financial statement users will be enhanced with the additional vintage disclosures. For public business entities that are SEC filers, the amendments of the update will become effective beginning January 1, 2020.

The Company has formed an internal task force that is responsible for oversight of the Company’s implementation strategy for compliance with provisions of the new standard. The Company has also established a project management governance process to manage the implementation across affected disciplines. An external provider specializing in community bank loss driver and CECL reserving model design as well as other related consulting services has been retained, and we have begun to evaluate potential CECL modeling alternatives. As part of this process, the Company has determined potential loan pool segmentation and sub-segmentation under CECL, as well as begun to evaluate the key economic loss drivers for each segment. Further, the Company has begun developing internal controls around the CECL process, data, calculations and implementation. The Company presently plans to generate and evaluate model scenarios under CECL in tandem with its current reserving processes for interim and annual reporting periods in 2019. While the Company is currently unable to reasonably estimate the impact of adopting this new guidance, management expects the impact of adoption will be significantly influenced by the composition and quality of the Company’s loans and investment securities as well as the economic conditions as of the date of adoption. The Company also anticipates significant changes to the processes and procedures for calculating the reserve for credit losses and continues to evaluate the potential impact on our consolidated financial statements.

FASB Accounting Standards Update (ASU) 2017-04 - Intangibles Goodwill and Other (Subtopic 350): Simplifying the Test for Goodwill Impairment, was issued January 2017. The provisions of the update eliminate the existing second step of the goodwill impairment test which provides for the allocation of reporting unit fair value among existing assets and liabilities, with the net leftover amount representing the implied fair value of goodwill. In replacement of the existing goodwill impairment rule, the update will provide that impairment should be recognized as the excess of any of the reporting unit’s goodwill over the fair value of the reporting unit. Under the provisions of this update, the amount of the impairment is limited to the carrying value of the reporting unit’s goodwill. For public business entities that are SEC filers, the amendments of the update will become effective in fiscal years beginning after December 15, 2019 with earlier adoption permitted. The Company adopted ASU 2017-04 effective during the first quarter of 2019 and it did not have a material impact on the Company’s financial position, results of operations or cash flows.

FASB Accounting Standards Update (ASU) 2017-08 - Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased

Callable Debt Securities, was issued March 2017. The provisions of the update require premiums recognized upon the purchase of callable debt securities to be amortized to the earliest call date in order to avoid losses recognized upon call. For public business entities that are SEC filers, the amendments of the update will become effective in fiscal years beginning after December 15, 2018. The Company adopted this ASU effective January 1, 2019 and it did not have a material impact on the Company’s financial position, results of operations or cash flows.

FASB Accounting Standards Update (ASU) 2017-09 - Compensation—Stock Compensation (Subtopic 718): Scope of Modification Accounting, was issued May 2017. The amendments in ASU 2017-09 provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. An entity should account for the effects of a modification unless all of the following conditions are met: the fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified; the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The amendments in this Update should be applied prospectively to an award modified on or after the adoption date. The amendments in this Update are effective for annual periods, and interim periods within those annual periods, beginning after December 31, 2017. The Company adopted this ASU effective January 1, 2018 and it did not have a material impact on the Company’s Consolidated Financial Statements.

FASB Accounting Standards Update (ASU) 2018-13 - Fair Value Measurement (Subtopic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement, was issued August 2018. The primary focus of ASU 2018-13 is to improve the effectiveness of the disclosure requirements for fair value measurements. The changes affect all companies that are required to include fair value measurement disclosures. In general, the amendments in ASU 2018-13 are effective for all entities for fiscal years and interim periods within those fiscal years, beginning after December 15, 2019. An entity is permitted to early adopt the removed or modified disclosures upon the issuance of ASU 2018-13 and may delay adoption of the additional disclosures, which are required for public companies only, until their effective date. Management is currently evaluating the impact these changes will have on the Company’s consolidated financial statements and disclosures.

2. ACQUISITIONS

On October 1, 2017, the Company completed the acquisition of Folsom Lake Bank (“FLB”) for an aggregate transaction value of \$28,475,000. FLB was merged into the Bank, and the Company issued 1,276,888 shares of common stock to the former shareholders of FLB. The Company also assumed the outstanding FLB stock options. With the FLB acquisition, the Company added two full service branches, located in Folsom, and Rancho Cordova, California. The FLB Roseville branch was consolidated with the Company’s Roseville branch in October 2017. FLB’s assets as of October 1, 2017 totaled approximately \$196,148,000.

In accordance with GAAP guidance for business combinations, the Company recorded \$13,466,000 of goodwill and \$1,879,000 of other intangible assets on the acquisition date. The other intangible assets are primarily related to core deposits and are being amortized using a straight-line method over a period of five years with no significant residual value. For tax purposes, purchase accounting adjustments including goodwill are all non-taxable and/or non-deductible. Acquisition related costs of \$217,000 and \$1,828,000 are included in the income statement for the years ended December 31, 2018 and 2017, respectively.

The acquisition was consistent with the Company’s strategy to build a regional presence in Central California. The acquisition offers the Company the opportunity to increase profitability by introducing existing products and services to the acquired customer base as well as add new customers in the expanded region. Goodwill arising from the acquisition consisted largely of synergies and the expected cost savings resulting from the combined operations.

Notes to Consolidated Financial Statements

2. ACQUISITIONS (Continued)

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

Merger consideration:	
Common stock issued	\$ 28,475
Fair Value of Total Consideration Transferred	<u>\$ 28,475</u>
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Cash and cash equivalents	\$ 26,279
Loans, net	117,815
Investments	41,280
Core deposit intangible	1,879
Premises and equipment	561
Federal Home Loan Bank stock	1,559
Deferred taxes and taxes receivable	2,186
Bank owned life insurance	3,997
Other assets	592
Total assets acquired	<u>196,148</u>
Deposits	171,948
Deposit premium	132
Short-term borrowings—Federal Home Loan Bank	7,000
Other liabilities	2,059
Total liabilities assumed	<u>181,139</u>
Total identifiable net assets	<u>15,009</u>
Goodwill	<u>\$ 13,466</u>

The fair value of net assets acquired includes fair value adjustments to certain loans that were not considered impaired as of the acquisition date. The fair value adjustments were determined using discounted contractual cash flows. As such, these loans were not considered impaired at the acquisition date and were not subject to the guidance relating to purchased credit impaired loans, which have shown evidence of credit deterioration since origination. Loans acquired that were not subject to these requirements include non-impaired loans and customer receivables with a fair value and gross contractual amounts receivable of \$117,815,000 and \$121,872,000, respectively, on the date of acquisition. See Note 5 for discussion of purchased credit impaired loans.

On October 1, 2016, the Company acquired Sierra Vista Bank, headquartered in Folsom, California, wherein Sierra Vista Bank, with one branch in Folsom, one branch in Fair Oaks, and one branch in Cameron Park, merged with and into Central Valley Community Bancorp's subsidiary, Central Valley Community Bank, in a combined cash and stock transaction. Sierra Vista Bank's assets as of October 1, 2016 totaled approximately \$155,154,000. The acquired assets and liabilities were recorded at fair value at the date of acquisition. Under the terms of the merger agreement, the Company issued an aggregate of approximately 1,058,851 shares of its common stock and cash totaling approximately \$9,468,000 to the former shareholders of Sierra Vista Bank.

In accordance with GAAP guidance for business combinations, the Company recorded \$10,314,000 of goodwill and \$508,000 of other intangible assets on the acquisition date. The other intangible assets are primarily related to core deposits and are being amortized using a straight-line method over a period of five years with no significant residual value. For tax purposes, purchase accounting adjustments including goodwill are all non-taxable and/or non-deductible. Acquisition related costs of \$1,782,000 are included in the income statement for the year ended December 31, 2016.

The acquisition was consistent with the Company's strategy to build a regional presence in Central California. The acquisition offers the Company the

opportunity to increase profitability by introducing existing products and services to the acquired customer base as well as add new customers in the expanded region. Goodwill arising from the acquisition consisted largely of synergies and the cost savings resulting from the combined operations.

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

Merger consideration:	
Cash	\$ 9,468
Common stock issued	<u>16,793</u>
Fair Value of Total Consideration Transferred	
	<u>\$ 26,261</u>
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Cash and cash equivalents	\$ 22,709
Loans, net	122,533
Core deposit intangible	508
Premises and equipment	586
Federal Home Loan Bank stock	771
Deferred taxes and taxes receivable	4,417
Bank owned life insurance	2,664
Other assets	966
Total assets acquired	<u>155,154</u>
Deposits	138,236
Deposit premium	142
Other liabilities	829
Total liabilities assumed	<u>139,207</u>
Total identifiable net assets	<u>15,947</u>
Goodwill	<u>\$ 10,314</u>

The fair value of net assets acquired includes fair value adjustments to certain loans that were not considered impaired as of the acquisition date. The fair value adjustments were determined using discounted contractual cash flows. As such, these loans were not considered impaired at the acquisition date and were not subject to the guidance relating to purchased credit impaired loans, which have shown evidence of credit deterioration since origination. Loans acquired that were not subject to these requirements include non-impaired loans and customer receivables with a fair value and gross contractual amounts receivable of \$121,902,000 and \$124,396,000, respectively, on the date of acquisition. See Note 5 for discussion of purchased credit impaired loans.

Pro Forma Results of Operations

The accompanying consolidated financial statements include the accounts of Sierra Vista Bank since October 1, 2016 and Folsom Lake Bank since October 1, 2017. The following table presents pro forma results of operations information for the periods presented as if the acquisitions had occurred on January 1, 2016 after giving effect to certain adjustments. The unaudited pro forma results of operations for the years ended December 31, 2017 and 2016 include the historical accounts of the Company, Folsom Lake Bank, and Sierra Vista Bank and pro forma adjustments as may be required, including the amortization of intangibles with definite lives and the amortization or accretion of any premiums or discounts arising from fair value adjustments for assets acquired and liabilities assumed. The pro forma information is intended for informational purposes only and is not necessarily indicative of the Company's future operating results or operating results that would have occurred had the acquisitions been completed at the beginning of each respective year. No assumptions have been applied to the pro forma results of operations regarding possible revenue enhancements,

Notes to Consolidated Financial Statements

2. ACQUISITIONS (Continued)

expense efficiencies or asset dispositions. (In thousands, except per-share amounts):

	For the Years Ended December 31,	
	2017	2016
Net interest income	\$61,059	\$56,531
Provision for (reversal of) credit losses	(1,150)	(5,800)
Non-interest income	11,240	10,205
Non-interest expense	51,415	52,131
Income before provision for income taxes	22,034	20,405
Provision for income taxes	9,168	6,381
Net income	\$12,866	\$14,024
Net income available to common shareholders	\$12,866	\$14,024
Basic earnings per common share	\$ 1.03	\$ 1.24
Diluted earnings per common share	\$ 1.01	\$ 1.23

3. FAIR VALUE MEASUREMENTS

Fair Value Hierarchy

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. In accordance with applicable guidance, the Company groups its assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Valuations within these levels are based upon:

Level - 1 Quoted market prices (unadjusted) for identical instruments traded in active exchange markets that the Company has the ability to access as of the measurement date.

Level - 2 Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level - 3 Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Company's estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, we report the transfer at the beginning of the reporting period.

The estimated carrying and fair values of the Company's financial instruments are as follows (in thousands):

	December 31, 2018				
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	\$ 24,954	\$ 24,954	\$ -	\$ -	\$ 24,954
Interest-earning deposits in other banks	6,725	6,725	-	-	6,725
Federal funds sold	48	48	-	-	48
Available-for-sale investment securities	463,905	-	463,905	-	463,905
Equity securities	7,254	7,254	-	-	7,254
Loans, net	909,591	-	-	899,214	899,214
Federal Home Loan Bank stock	6,843	N/A	N/A	N/A	N/A
Accrued interest receivable	6,429	32	2,323	4,074	6,429
Financial liabilities:					
Deposits	1,282,298	1,031,369	95,633	-	1,127,002
Short-term borrowings	10,000	-	10,000	-	10,000
Junior subordinated deferrable interest debentures	5,155	-	-	4,114	4,114
Accrued interest payable	134	-	81	53	134
December 31, 2017					
	Carrying Amount	Fair Value			
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	\$ 38,286	\$ 38,286	\$ -	\$ -	\$ 38,286
Interest-earning deposits in other banks	62,080	62,080	-	-	62,080
Federal funds sold	17	17	-	-	17
Available-for-sale investment securities	535,281	-	535,281	-	535,281
Equity securities	7,423	7,423	-	-	7,423
Loans, net	891,901	-	-	899,191	899,191
Federal Home Loan Bank stock	6,843	N/A	N/A	N/A	N/A
Accrued interest receivable	7,168	57	3,256	3,855	7,168
Financial liabilities:					
Deposits	1,425,687	1,296,048	127,966	-	1,424,014
Junior subordinated deferrable interest debentures	5,155	-	-	3,550	3,550
Accrued interest payable	110	-	72	38	110

These estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant

Notes to Consolidated Financial Statements

3. FAIR VALUE MEASUREMENTS (Continued)

judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the fair values presented.

The methods and assumptions used to estimate fair values are described as follows:

(a) Cash and Cash Equivalents - The carrying amounts of cash and due from banks, interest-earning deposits in other banks, and Federal funds sold approximate fair values and are classified as Level 1.

(b) Investment Securities - Investment securities in Level 1 are mutual funds and fair values are based on quoted market prices for identical instruments traded in active markets. Fair values for investment securities classified in Level 2 are based on quoted market prices for similar securities in active markets. For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators.

(c) Loans - Fair values of loans are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Purchased credit impaired (PCI) loans are measured at estimated fair value on the date of acquisition. Carrying value is calculated as the present value of expected cash flows and approximates fair value and included in Level 3. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are initially valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for credit losses. For collateral dependent real estate loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. The estimated fair values of financial instruments disclosed above as of December 31, 2018 follow the guidance in ASU 2016-01 which prescribes an "exit price" approach in estimating and disclosing fair value of financial instruments incorporating discounts for credit, liquidity, and marketability factors. The fair values shown as of December 31, 2017 use an "entry price" approach.

(d) FHLB Stock - It is not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability.

(e) Deposits - Fair value of demand deposit, savings, and money market accounts are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 1 classification. Fair value for fixed and variable rate certificates of deposit are estimated using discounted cash flow analyses using interest rates offered at each reporting date by the Company for certificates with similar remaining maturities resulting in a Level 2 classification.

(f) Short-Term Borrowings - The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings, generally maturing within ninety days, approximate their fair values resulting in a Level 2 classification.

The fair values of the Company's Subordinated Debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.

(g) Accrued Interest Receivable/Payable - The fair value of accrued interest receivable and payable is based on the fair value hierarchy of the related asset or liability.

(h) Off-Balance Sheet Instruments - Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments is not material.

Assets Recorded at Fair Value

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and non-recurring basis as of December 31, 2018:

Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis under other accounting pronouncements (in thousands):

	Fair Value	Level 1	Level 2	Level 3
Available-for-sale investment securities:				
Debt Securities:				
U.S. Government agencies	\$ 21,321	\$ -	\$ 21,321	\$ -
Obligations of states and political subdivisions	81,504	-	81,504	-
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	234,930	-	234,930	-
Private label mortgage and asset backed securities	126,150	-	126,150	-
Equity Securities	7,254	7,254	-	-
Total assets measured at fair value on a recurring basis	\$ 471,159	\$ 7,254	\$ 463,905	\$ -

Securities in Level 1 are mutual funds and fair values are based on quoted market prices for identical instruments traded in active markets. Fair values for available-for-sale investment securities in Level 2 are based on quoted market prices for similar securities in active markets. For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings. During the year ended December 31, 2018, no transfers between levels occurred.

There were no Level 3 assets measured at fair value on a recurring basis at December 31, 2018. Also there were no liabilities measured at fair value on a recurring basis at December 31, 2018.

Non-recurring Basis

The Company may be required, from time to time, to measure certain assets and liabilities at fair value on a non-recurring basis. These include the following assets and liabilities that are measured at the lower of cost or fair value that were

Notes to Consolidated Financial Statements

3. FAIR VALUE MEASUREMENTS (Continued)

recognized at fair value which was below cost at December 31, 2018 (in thousands):

	Fair Value	Level 1	Level 2	Level 3
Impaired loans:				
Real estate:				
Commercial real estate	\$ 134	\$ -	\$ -	\$ 134
Total assets measured at fair value on a non-recurring basis	\$ 134	\$ -	\$ -	\$ 134

At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for credit losses. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. The fair value of impaired loans is based on the fair value of the collateral. Impaired loans were determined to be collateral dependent and categorized as Level 3 due to ongoing real estate market conditions resulting in inactive market data, which in turn required the use of unobservable inputs and assumptions in fair value measurements. Impaired loans evaluated under the discounted cash flow method are excluded from the table above. The discounted cash flow method as prescribed by ASC 310 is not a fair value measurement since the discount rate utilized is the loan's effective interest rate which is not a market rate. There were no changes in valuation techniques used during the year ended December 31, 2018.

Appraisals for collateral-dependent impaired loans are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value is compared with independent data sources such as recent market data or industry-wide statistics.

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans in which the collateral value did not exceed the loan balance had a principal balance of \$161,000 with a valuation allowance of \$27,000 at December 31, 2018, resulting in a fair value of \$134,000. The valuation allowance represent specific allocation for the allowance for credit losses for impaired loans.

During the year ended December 31, 2018 specific allocation for the allowance for credit losses related to loans carried at fair value was \$27,000, compared to none during the year ended December 31, 2017. There were no net charge-offs related to loans carried at fair value at December 31, 2018 and 2017.

There were no liabilities measured at fair value on a non-recurring basis at December 31, 2018.

The following two tables present information about the Company's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2017:

Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis under other accounting pronouncements (in thousands):

	Fair Value	Level 1	Level 2	Level 3
Available-for-sale securities				
Debt Securities:				
U.S. Government agencies	\$ 66,587	\$ -	\$ 66,587	\$ -
Obligations of states and political subdivisions	143,105	-	143,105	-
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	234,908	-	234,908	-
Private label residential mortgage and asset backed securities	90,681	-	90,681	-
Other equity securities	7,423	7,423	-	-
Total assets measured at fair value on a recurring basis	\$ 542,704	\$ 7,423	\$ 535,281	\$ -

Securities in Level 1 are mutual funds and fair values are based on quoted market prices for identical instruments traded in active markets. Fair values for available-for-sale investment securities in Level 2 are based on quoted market prices for similar securities in active markets. For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings. During the year ended December 31, 2017, no transfers between levels occurred.

There were no Level 3 assets measured at fair value on a recurring basis at December 31, 2017. Also there were no liabilities measured at fair value on a recurring basis at December 31, 2017.

Non-recurring Basis

The Company may be required, from time to time, to measure certain assets and liabilities at fair value on a non-recurring basis. These include the following assets and liabilities that are measured at the lower of cost or fair value that were recognized at fair value which was below cost at December 31, 2017 (in thousands):

	Fair Value	Level 1	Level 2	Level 3
Other repossessed assets	\$ 70	\$ -	\$ -	\$ 70
Total assets measured at fair value on a non-recurring basis	\$ 70	\$ -	\$ -	\$ 70

As of December 31, 2017, there were no loans measured using the fair value of the collateral for collateral dependent loans.

There were no liabilities measured at fair value on a non-recurring basis at December 31, 2017.

Notes to Consolidated Financial Statements

4. INVESTMENT SECURITIES

The fair value of the available-for-sale investment portfolio reflected an unrealized loss of \$(6,257,000) at December 31, 2018 compared to an unrealized gain of \$4,089,000 at December 31, 2017. The unrealized (loss)/gain recorded is net of \$(1,850,000) and \$1,186,000 in tax (benefits) liabilities as accumulated other comprehensive income within shareholders' equity at December 31, 2018 and 2017, respectively.

The following tables set forth the carrying values and estimated fair values of our investment securities portfolio at the dates indicated (in thousands):

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale Securities				
Debt Securities:				
U.S. Government agencies	\$ 21,723	\$ -	\$ (402)	\$ 21,321
Obligations of states and political subdivisions	79,886	2,205	(587)	81,504
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	239,388	253	(4,711)	234,930
Private label mortgage and asset backed securities	129,165	756	(3,771)	126,150
	\$ 470,162	\$ 3,214	\$ (9,471)	\$ 463,905
	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale Securities				
Debt Securities:				
U.S. Government agencies	\$ 65,994	\$ 667	\$ (74)	\$ 66,587
Obligations of states and political subdivisions	136,955	6,240	(90)	143,105
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	237,210	601	(2,903)	234,908
Private label residential mortgage backed securities	91,033	924	(1,276)	90,681
	\$ 531,192	\$ 8,432	\$ (4,343)	\$ 535,281

Proceeds and gross realized gains (losses) on investment securities for the years ended December 31, 2018, 2017, and 2016 are shown below (in thousands):

	Years Ended December 31,		
	2018	2017	2016
Available-for-Sale Securities			
Proceeds from sales or calls	\$ 246,824	\$ 228,405	\$ 167,163
Gross realized gains from sales or calls	\$ 1,976	\$ 4,701	\$ 2,223
Gross realized losses from sales or calls	\$ (662)	\$ (1,899)	\$ (999)
Held-to-Maturity Securities			
Proceeds from sales and calls	\$ —	\$ —	\$ 9,257
Gross realized gains from sales or calls	\$ —	\$ —	\$ 696

Losses recognized in 2018, 2017, and 2016 were incurred in order to reposition the investment securities portfolio based on the current rate

environment. The securities which were sold at a loss were acquired when the rate environment was not as volatile. The securities which were sold were primarily purchased several years ago to serve a purpose in the rate environment in which the securities were purchased. The Company addressed risks in the security portfolio by selling these securities and using the proceeds to purchase securities that fit with the Company's current risk profile.

The provision (benefit) for income taxes includes \$388,000, \$1,178,000, and \$515,000 income tax impact from the reclassification of unrealized net gains on available-for-sale securities to realized net gains on available-for-sale securities for the years ended December 31, 2018, 2017, and 2016, respectively.

Investment securities with unrealized losses at December 31, 2018 and 2017 are summarized and classified according to the duration of the loss period as follows (in thousands):

	December 31, 2018					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale Securities						
Debt Securities:						
U.S. Government agencies	\$ 14,891	\$ (254)	\$ 6,430	\$ (148)	\$ 21,321	\$ (402)
Obligations of states and political subdivisions	10,056	(99)	22,945	(488)	33,001	(587)
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	61,866	(424)	124,673	(4,287)	186,539	(4,711)
Private label residential mortgage and asset backed securities	31,325	(195)	84,784	(3,576)	116,109	(3,771)
	\$ 118,138	\$ (972)	\$ 238,832	\$ (8,499)	\$ 356,970	\$ (9,471)

	December 31, 2017					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale Securities						
Debt Securities:						
U.S. Government agencies	\$ 8,201	\$ (47)	\$ 6,741	\$ (27)	\$ 14,942	\$ (74)
Obligations of states and political subdivisions	1,627	(3)	3,357	(87)	4,984	(90)
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	82,604	(822)	64,488	(2,081)	147,092	(2,903)
Private label residential mortgage backed securities	88,312	(1,276)	—	—	88,312	(1,276)
	\$ 180,744	\$ (2,148)	\$ 74,586	\$ (2,195)	\$ 255,330	\$ (4,343)

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

As of December 31, 2018, the Company performed an analysis of the investment portfolio to determine whether any of the investments held in the portfolio had an other-than-temporary impairment (OTTI). Management evaluated all investment securities with an unrealized loss at December 31, 2018, and identified those that had an unrealized loss for at least a consecutive 12 month period, which had an unrealized loss at December 31, 2018 greater than 10% of the recorded book value on that date, or which had an unrealized loss of more than \$10,000. Management also analyzed any securities that may have been downgraded by credit rating agencies.

For those bonds that met the evaluation criteria, management obtained and reviewed the most recently published national credit ratings for those bonds. For

Notes to Consolidated Financial Statements

4. INVESTMENT SECURITIES (Continued)

those bonds that were obligations of states and political subdivisions with an investment grade rating by the rating agencies, management also evaluated the financial condition of the municipality and any applicable municipal bond insurance provider and concluded during March 2016 that \$136,000 credit related impairment related to one security with a fair value of \$2,995,000 and a pre-impairment amortized cost of \$3,131,000 existed. The Company recorded an other-than-temporary impairment loss of \$136,000 during the twelve months ended December 31, 2016. There were no OTTI losses recorded during the twelve months ended December 31, 2018 or December 31, 2017.

U.S. Government Agencies - At December 31, 2018, the Company held six U.S. Government agency securities of which four were in a loss position for less than 12 months and two were in a loss position and had been in a loss position for 12 months or more. The unrealized losses on the Company's investments in U.S. Government Agencies were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized costs of the investment. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell, and it is more likely than not that it will not be required to sell those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2018.

Obligations of States and Political Subdivisions - At December 31, 2018, the Company held 52 obligations of states and political subdivision securities of which two were in a loss position for less than 12 months and eight were in a loss position or had been in a loss position for 12 months or more. The unrealized losses on the Company's investments in obligations of states and political subdivision securities were caused by interest rate changes. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell, and it is more likely than not that it will not be required to sell those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2018.

U.S. Government Sponsored Entities and Agencies Collateralized by Residential Mortgage Obligations - At December 31, 2018, the Company held 137 U.S. Government sponsored entity and agency securities collateralized by residential mortgage obligation securities of which 23 were in a loss position for less than 12 months and 60 have been in a loss position for more than 12 months. The unrealized losses on the Company's investments in U.S. Government sponsored entity and agencies collateralized by residential mortgage obligations were caused by interest rate changes. The contractual cash flows of those investments are guaranteed or supported by an agency or sponsored entity of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company's investment. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell, and it is more likely than not that it will not be required to sell those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2018.

Private Label Mortgage and Asset Backed Securities - At December 31, 2018, the Company had a total of 36 PLMBS with a remaining principal balance of \$129,165,000 and a gross and net unrealized loss of approximately \$3,016,000.

Seven of these securities were in a loss position for less than 12 months and 18 have been in a loss position for more than 12 months at December 31, 2018. Eight of these PLMBS with a remaining principal balance of \$1,137,000 had credit ratings below investment grade. The Company continues to monitor these securities for changes in credit ratings or other indications of credit deterioration. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell, and it is more likely than not that it will not be required to sell those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2018.

The following table provides a rollforward for the years ended December 31, 2018 and 2017 of investment securities credit losses recorded in earnings (in thousands). The beginning balance represents the credit loss component for which OTTI occurred on debt securities in prior periods. Additions represent the first time a debt security was credit impaired or when subsequent credit impairments have occurred on securities for which OTTI credit losses have been previously recognized.

	Years ended December 31,	
	2018	2017
Beginning balance of credit losses recognized	\$ 874	\$ 874
Amounts related to credit loss for which an OTTI charge was not previously recognized	—	—
Realized losses for securities sold	—	—
Ending balance of credit losses recognized	\$ 874	\$ 874

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2018 and 2017 by contractual maturity are shown in the two tables below (in thousands). Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2018		December 31, 2017	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Within one year	\$ —	\$ —	\$ 1,893	\$ 1,914
After one year through five years	2,769	2,899	7,149	7,316
After five years through ten years	21,831	22,278	22,043	22,696
After ten years	55,286	56,327	105,870	111,179
	79,886	81,504	136,955	143,105
Investment securities not due at a single maturity date:				
Treasuries	—	—	—	—
U.S. Government agencies	21,723	21,321	65,994	66,587
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	239,388	234,930	237,210	234,908
Private label mortgage and asset backed securities	129,165	126,150	91,033	90,681
	\$ 470,162	\$ 463,905	\$ 531,192	\$ 535,281

Investment securities with amortized costs totaling \$80,001,000 and \$88,930,000 and fair values totaling \$79,662,000 and \$90,541,000 were pledged as collateral for borrowing arrangements, public funds and for other purposes at December 31, 2018 and 2017, respectively.

Notes to Consolidated Financial Statements

5. LOANS AND ALLOWANCE FOR CREDIT LOSSES

Outstanding loans are summarized as follows (in thousands):

Loan Type	December 31, 2018	% of Total loans	December 31, 2017	% of Total loans
Commercial:				
Commercial and industrial	\$ 101,533	11.1%	\$ 100,856	11.2%
Agricultural production	7,998	0.9%	14,956	1.7%
Total commercial	109,531	12.0%	115,812	12.9%
Real estate:				
Owner occupied	183,169	19.9%	204,452	22.7%
Real estate construction and other land loans	101,606	11.1%	96,460	10.7%
Commercial real estate	305,118	33.2%	269,254	29.9%
Agricultural real estate	76,884	8.4%	76,081	8.4%
Other real estate	32,799	3.6%	31,220	3.5%
	699,576	76.2%	677,467	75.2%
Consumer:				
Equity loans and lines of credit	69,958	7.6%	76,404	8.5%
Consumer and installment	38,038	4.2%	29,637	3.4%
Total consumer	107,996	11.8%	106,041	11.9%
Net deferred origination costs	1,592		1,359	
Total gross loans	918,695	100.0%	900,679	100.0%
Allowance for credit losses	(9,104)		(8,778)	
Total loans	\$ 909,591		\$ 891,901	

At December 31, 2018 and 2017, loans originated under Small Business Administration (SBA) programs totaling \$22,297,000 and \$25,925,000, respectively, were included in the real estate and commercial categories. Approximately \$447,757,000 in loans were pledged under a blanket lien as collateral to the FHLB for the Bank's remaining borrowing capacity of

\$286,934,000 as of December 31, 2018. The Bank's credit limit varies according to the amount and composition of the investment and loan portfolios pledged as collateral.

Salaries and employee benefits totaling \$2,453,000, \$2,593,000, and \$2,344,000 have been deferred as loan origination costs for the years ended December 31, 2018, 2017, and 2016, respectively.

Allowance for Credit Losses

The allowance for credit losses (the "allowance") is a valuation allowance for probable incurred credit losses in the Company's loan portfolio. The allowance is established through a provision for credit losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged-off credits is recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired loans and general reserves for probable incurred losses related to loans that are not impaired.

For all portfolio segments, the determination of the general reserve for loans that are not impaired is based on estimates made by management, including but not limited to, consideration of historical losses by portfolio segment (and in certain cases peer loss data) over the most recent 20 quarters, and qualitative factors including economic trends in the Company's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio taken as a whole.

Changes in the allowance for credit losses were as follows (in thousands):

	Years Ended December 31,		
	2018	2017	2016
Balance, beginning of year	\$ 8,778	\$ 9,326	\$ 9,610
Provision (reversal) charged to operations	50	(1,150)	(5,850)
Losses charged to allowance	(210)	(464)	(883)
Recoveries	486	1,066	6,449
Balance, end of year	\$ 9,104	\$ 8,778	\$ 9,326

The following table shows the summary of activities for the allowance for credit losses as of and for the years ended December 31, 2018, 2017, and 2016 by portfolio segment (in thousands):

	Commercial	Real Estate	Consumer	Unallocated	Total
Allowance for credit losses:					
Beginning balance, January 1, 2018	\$ 2,071	\$ 5,795	\$ 825	\$ 87	\$ 8,778
(Reversal) provision charged to operations	(513)	642	(60)	(19)	50
Losses charged to allowance	(94)	—	(116)	—	(210)
Recoveries	207	102	177	—	486
Ending balance, December 31, 2018	\$ 1,671	\$ 6,539	\$ 826	\$ 68	\$ 9,104
Allowance for credit losses:					
Beginning balance, January 1, 2017	\$ 2,180	\$ 6,200	\$ 852	\$ 94	\$ 9,326
(Reversal) provision charged to operations	(762)	(449)	68	(7)	(1,150)
Losses charged to allowance	(207)	(22)	(235)	—	(464)
Recoveries	860	66	140	—	1,066
Ending balance, December 31, 2017	\$ 2,071	\$ 5,795	\$ 825	\$ 87	\$ 8,778
Allowance for credit losses:					
Beginning balance, January 1, 2016	\$ 3,562	\$ 5,204	\$ 734	\$ 110	\$ 9,610
(Reversal) provision charged to operations	(6,048)	11	203	(16)	(5,850)
Losses charged to allowance	(621)	—	(262)	—	(883)
Recoveries	5,287	985	177	—	6,449
Ending balance, December 31, 2016	\$ 2,180	\$ 6,200	\$ 852	\$ 94	\$ 9,326

Notes to Consolidated Financial Statements

5. LOANS AND ALLOWANCE FOR CREDIT LOSSES (Continued)

The following is a summary of the allowance for credit losses by impairment methodology and portfolio segment as of December 31, 2018 and December 31, 2017 (in thousands):

	Commercial	Real Estate	Consumer	Unallocated	Total
Allowance for credit losses:					
Ending balance, December 31, 2018	\$ 1,671	\$ 6,539	\$ 826	\$ 68	\$ 9,104
Ending balance: individually evaluated for impairment	\$ 9	\$ 27	\$ 54	\$ -	\$ 90
Ending balance: collectively evaluated for impairment	\$ 1,662	\$ 6,512	\$ 772	\$ 68	\$ 9,014
Ending balance, December 31, 2017	\$ 2,071	\$ 5,795	\$ 825	\$ 87	\$ 8,778
Ending balance: individually evaluated for impairment	\$ 1	\$ 1	\$ 34	\$ -	\$ 36
Ending balance: collectively evaluated for impairment	\$ 2,070	\$ 5,794	\$ 791	\$ 87	\$ 8,742

The following table shows the ending balances of loans as of December 31, 2018 and December 31, 2017 by portfolio segment and by impairment methodology (in thousands):

	Commercial	Real Estate	Consumer	Total
Loans:				
Ending balance, December 31, 2018	\$ 109,531	\$ 699,576	\$ 107,996	\$ 917,103
Ending balance: individually evaluated for impairment	\$ 348	\$ 4,215	\$ 1,346	\$ 5,909
Ending balance: collectively evaluated for impairment	\$ 109,183	\$ 695,361	\$ 106,650	\$ 911,194
Loans:				
Ending balance, December 31, 2017	\$ 115,812	\$ 677,467	\$ 106,041	\$ 899,320
Ending balance: individually evaluated for impairment	\$ 377	\$ 4,846	\$ 1,143	\$ 6,366
Ending balance: collectively evaluated for impairment	\$ 115,435	\$ 672,621	\$ 104,898	\$ 892,954

The following table shows the loan portfolio by class allocated by management's internal risk ratings at December 31, 2018 (in thousands):

	Pass	Special Mention	Substandard	Doubtful	Total
Commercial:					
Commercial and industrial	\$ 86,876	\$ 12,072	\$ 2,585	\$ -	\$ 101,533
Agricultural production	5,955	2,043	-	-	7,998
Real Estate:					
Owner occupied	179,214	3,056	899	-	183,169
Real estate construction and other land loans	95,301	3,270	3,035	-	101,606
Commercial real estate	298,714	5,268	1,136	-	305,118
Agricultural real estate	57,544	165	19,175	-	76,884
Other real estate	32,799	-	-	-	32,799
Consumer:					
Equity loans and lines of credit	68,016	380	1,562	-	69,958
Consumer and installment	38,036	-	2	-	38,038
Total	\$ 862,455	\$ 26,254	\$ 28,394	\$ -	\$ 917,103

Notes to Consolidated Financial Statements

5. LOANS AND ALLOWANCE FOR CREDIT LOSSES (Continued)

The following table shows the loan portfolio by class allocated by management's internally assigned risk grade ratings at December 31, 2017 (in thousands):

	Pass	Special Mention	Substandard	Doubtful	Total
Commercial:					
Commercial and industrial	\$ 84,745	\$ 8,217	\$ 7,894	\$ -	\$ 100,856
Agricultural production	10,848	206	3,902	-	14,956
Real Estate:					
Owner occupied	196,838	4,795	2,819	-	204,452
Real estate construction and other land loans	90,927	1,625	3,908	-	96,460
Commercial real estate	261,746	4,147	3,361	-	269,254
Agricultural real estate	48,274	1,270	26,537	-	76,081
Other real estate	29,867	1,165	188	-	31,220
Consumer:					
Equity loans and lines of credit	74,535	483	1,386	-	76,404
Consumer and installment	29,634	-	3	-	29,637
Total	<u>\$ 827,414</u>	<u>\$ 21,908</u>	<u>\$ 49,998</u>	<u>\$ -</u>	<u>\$ 899,320</u>

The following table shows an aging analysis of the loan portfolio by class and the time past due at December 31, 2018 (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days Accruing	Non-accrual
Commercial:								
Commercial and industrial	\$ 255	\$ -	\$ -	\$ 255	\$ 101,278	\$ 101,533	\$ -	\$ 298
Agricultural production	-	-	-	-	7,998	7,998	-	-
Real estate:								
Owner occupied	215	-	-	215	182,954	183,169	-	215
Real estate construction and other land loans	-	-	1,439	1,439	100,167	101,606	-	1,439
Commercial real estate	-	-	-	-	305,118	305,118	-	418
Agricultural real estate	-	-	-	-	76,884	76,884	-	-
Other real estate	-	-	-	-	32,799	32,799	-	-
Consumer:								
Equity loans and lines of credit	953	-	-	953	69,005	69,958	-	370
Consumer and installment	7	-	-	7	38,031	38,038	-	-
Total	<u>\$ 1,430</u>	<u>\$ -</u>	<u>\$ 1,439</u>	<u>\$ 2,869</u>	<u>\$ 914,234</u>	<u>\$ 917,103</u>	<u>\$ -</u>	<u>\$ 2,740</u>

The following table shows an aging analysis of the loan portfolio by class and the time past due at December 31, 2017 (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days Accruing	Non-accrual
Commercial:								
Commercial and industrial	\$ -	\$ -	\$ -	\$ -	\$ 100,856	\$ 100,856	\$ -	\$ 356
Agricultural production	-	-	-	-	14,956	14,956	-	-
Real estate:								
Owner occupied	-	-	-	-	204,452	204,452	-	-
Real estate construction and other land loans	-	-	1,397	1,397	95,063	96,460	-	1,397
Commercial real estate	-	-	-	-	269,254	269,254	-	976
Agricultural real estate	-	-	-	-	76,081	76,081	-	-
Other real estate	-	1,165	-	1,165	30,055	31,220	-	-
Consumer:								
Equity loans and lines of credit	149	-	-	149	76,255	76,404	-	146
Consumer and installment	26	-	-	26	29,611	29,637	-	-
Total	<u>\$ 175</u>	<u>\$ 1,165</u>	<u>\$ 1,397</u>	<u>\$ 2,737</u>	<u>\$ 896,583</u>	<u>\$ 899,320</u>	<u>\$ -</u>	<u>\$ 2,875</u>

Notes to Consolidated Financial Statements

5. LOANS AND ALLOWANCE FOR CREDIT LOSSES (Continued)

The following table shows information related to impaired loans by class at December 31, 2018 (in thousands):

	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial:			
Commercial and industrial	\$ 259	\$ 493	\$ -
Real estate:			
Owner occupied	215	215	-
Real estate construction and other land loans	2,613	2,676	-
Commercial real estate	1,182	1,414	-
Total real estate	4,010	4,305	-
Consumer:			
Equity loans and lines of credit	248	285	-
Total with no related allowance recorded	4,517	5,083	-
With an allowance recorded:			
Commercial:			
Commercial and industrial	89	90	9
Real estate:			
Commercial real estate	161	162	27
Agricultural real estate	44	44	-
Total real estate	205	206	27
Consumer:			
Equity loans and lines of credit	1,098	1,103	54
Total with an allowance recorded	1,392	1,399	90
Total	\$ 5,909	\$ 6,482	\$ 90

The recorded investment in loans excludes accrued interest receivable and net loan origination fees, due to immateriality.

The following table shows information related to impaired loans by class at December 31, 2017 (in thousands):

	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial:			
Commercial and industrial	\$ 355	\$ 553	\$ -
Real estate:			
Real estate construction and other land loans	3,023	3,085	-
Commercial real estate	1,772	2,040	-
Total real estate	4,795	5,125	-
Consumer:			
Equity loans and lines of credit	146	206	-
Total with no related allowance recorded	5,296	5,884	-
With an allowance recorded:			
Commercial:			
Commercial and industrial	22	22	1
Real estate:			
Agricultural real estate	51	51	1
Consumer:			
Equity loans and lines of credit	997	997	34
Total with an allowance recorded	1,070	1,070	36
Total	\$ 6,366	\$ 6,954	\$ 36

The recorded investment in loans excludes accrued interest receivable and net loan origination fees, due to immateriality.

Notes to Consolidated Financial Statements

5. LOANS AND ALLOWANCE FOR CREDIT LOSSES (Continued)

The following presents by class, information related to the average recorded investment and interest income recognized on impaired loans for the years ended December 31, 2018, 2017, and 2016 (in thousands):

	Year Ended December 31, 2018		Year Ended December 31, 2017		Year Ended December 31, 2016	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:						
Commercial:						
Commercial and industrial	\$ 311	\$ -	\$ 404	\$ -	\$ 115	\$ -
Agricultural production	-	-	-	-	42	-
Total commercial	311	-	404	-	157	-
Real estate:						
Owner occupied	17	-	24	-	162	-
Real estate construction and other land loans	2,857	85	1,228	114	2,393	196
Commercial real estate	1,542	51	1,370	53	903	55
Agricultural real estate	1,173	159	-	-	173	-
Other real estate	702	-	-	-	-	-
Total real estate	6,291	295	2,622	167	3,631	251
Consumer:						
Equity loans and lines of credit	217	-	132	-	598	-
Consumer and installment	-	-	6	-	41	-
Total consumer	217	-	138	-	639	-
Total with no related allowance recorded	6,819	295	3,164	167	4,427	251
With an allowance recorded:						
Commercial:						
Commercial and industrial	55	4	38	1	441	3
Agricultural production	-	-	-	-	104	-
Total commercial	55	4	38	1	545	3
Real estate:						
Owner occupied	-	-	-	-	120	-
Real estate construction and other land loans	-	-	1,827	-	171	-
Commercial real estate	200	12	470	-	548	-
Agricultural real estate	49	3	43	3	-	-
Other real estate	86	-	-	-	-	-
Total real estate	335	15	2,340	3	839	-
Consumer:						
Equity loans and lines of credit	1,054	57	239	32	203	-
Consumer and installment	3	-	1	-	19	-
Total consumer	1,057	57	240	32	222	-
Total with an allowance recorded	1,447	76	2,618	36	1,606	3
Total	\$ 8,266	\$ 371	\$ 5,782	\$ 203	\$ 6,033	\$ 254

Foregone interest on nonaccrual loans totaled \$267,000, \$210,000, and \$245,000 for the years ended December 31, 2018, 2017, and 2016, respectively. Interest income recognized on cash basis during the years presented above was not considered significant for financial reporting purposes.

Troubled Debt Restructurings:

As of December 31, 2018 and 2017, the Company has a recorded investment in troubled debt restructurings of \$3,220,000 and, \$3,551,000, respectively. The Company has allocated \$50,000 and \$36,000 of specific reserves for those loans at December 31, 2018 and 2017, respectively. The Company has committed to

lend no additional amounts as of December 31, 2018 to customers with outstanding loans that are classified as troubled debt restructurings.

For the years ended December 31, 2018, 2017, and 2016 the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk. During the same periods, there were no troubled debt restructurings in which the amount of principal or accrued interest owed from the borrower were forgiven.

Notes to Consolidated Financial Statements

5. LOANS AND ALLOWANCE FOR CREDIT LOSSES (Continued)

The following table presents loans by class modified as troubled debt restructurings that occurred during the year ended December 31, 2018 (dollars in thousands):

	Number of Loans	Pre- Modification Outstanding Recorded Investment (1)	Principal Modification	Post Modification Outstanding Recorded Investment (2)	Outstanding Recorded Investment
Troubled Debt Restructurings:					
Commercial:					
Commercial and industrial	1	\$ 38	\$ -	\$ 38	\$ 30
Real Estate:					
Real Estate—Commercial	1	166	-	166	161
Total	2	\$ 204	\$ -	\$ 204	\$ 191

(1) Amounts represent the recorded investment in loans before recognizing effects of the TDR, if any.

(2) Balance outstanding after principal modification, if any borrower reduction to recorded investment.

The following table presents loans by class modified as troubled debt restructurings that occurred during the year ended December 31, 2017 (dollars in thousands):

	Number of Loans	Pre-Modification Outstanding Recorded Investment (1)	Principal Modification	Post Modification Outstanding Recorded Investment (2)	Outstanding Recorded Investment
Troubled Debt Restructurings:					
Real Estate:					
Agricultural real estate	1	\$ 59	\$ -	\$ 59	\$ 51
Consumer					
Equity loans and line of credit	2	490	-	1,066	1,059
Total	3	\$ 549	\$ -	\$ 1,125	\$ 1,110

(1) Amounts represent the recorded investment in loans before recognizing effects of the TDR, if any.

(2) Balance outstanding after principal modification, if any borrower reduction to recorded investment.

The following table presents loans by class modified as troubled debt restructurings that occurred during the year ended December 31, 2016 (dollars in thousands):

	Number of Loans	Pre-Modification Outstanding Recorded Investment (1)	Principal Modification	Post Modification Outstanding Recorded Investment (2)	Outstanding Recorded Investment
Troubled Debt Restructurings:					
Commercial:					
Commercial and Industrial	2	\$ 45	\$ -	\$ 45	\$ 40

(1) Amounts represent the recorded investment in loans before recognizing effects of the TDR, if any.

(2) Balance outstanding after principal modification, if any borrower reduction to recorded investment.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. There were no defaults on troubled debt

restructurings within 12 months following the modification during the years ended December 31, 2018, 2017, and 2016.

Notes to Consolidated Financial Statements

6. BANK PREMISES AND EQUIPMENT

Bank premises and equipment consisted of the following (in thousands):

	December 31,	
	2018	2017
Land	\$ 1,131	\$ 1,131
Buildings and improvements	6,753	6,754
Furniture, fixtures and equipment	12,665	12,345
Leasehold improvements	4,369	4,594
	24,918	24,824
Less accumulated depreciation and amortization	(16,434)	(15,426)
	<u>\$ 8,484</u>	<u>\$ 9,398</u>

Depreciation and amortization included in occupancy and equipment expense totaled \$1,703,000, \$1,429,000 and \$1,320,000 for the years ended December 31, 2018, 2017, and 2016, respectively.

7. GOODWILL AND INTANGIBLE ASSETS

The change in goodwill during the years ended December 31, 2018, 2017, and 2016 is as follows (in thousands):

	2018	2017	2016
Balance, beginning of year	\$ 53,777	\$ 40,231	\$ 29,917
Acquired goodwill	-	13,546	10,314
Impairment	-	-	-
Balance, end of year	<u>\$ 53,777</u>	<u>\$ 53,777</u>	<u>\$ 40,231</u>

Business combinations involving the Company's acquisition of the equity interests or net assets of another enterprise give rise to goodwill. Total goodwill at December 31, 2018 and 2017 was \$53,777,000. Total goodwill at December 31, 2018 consisted of \$13,466,000, \$10,394,000, \$6,340,000, \$14,643,000, and \$8,934,000 representing the excess of the cost of Folsom Lake Bank, Sierra Vista Bank, Visalia Community Bank, Service 1st Bancorp, and Bank of Madera County, respectively, over the net of the amounts assigned to assets acquired and liabilities assumed in the transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Company's ability to generate net earnings after the acquisitions and is not deductible for tax purposes. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed at least annually for impairment.

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

Goodwill is also tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the Company below its carrying amount. No such events or circumstances arose during the fourth quarter of 2018, so goodwill was not required to be retested.

The intangible assets at December 31, 2018 represent the estimated fair value of the core deposit relationships acquired in the acquisition of Folsom Lake Bank in 2017 of \$1,879,000, Sierra Vista Bank in 2016 of \$508,000 and the 2013 acquisition of Visalia Community Bank of \$1,365,000. Core deposit intangibles are being amortized using the straight-line method over an estimated life of five to ten years from the date of acquisition. At December 31, 2018, the weighted average remaining amortization period is four years. The carrying value of intangible assets at December 31, 2018 was \$2,572,000, net of \$1,180,000 in accumulated amortization expense. The carrying value at December 31, 2017 was \$3,027,000, net of \$725,000 in accumulated amortization expense. Management evaluates the remaining useful lives quarterly to determine whether events or

circumstances warrant a revision to the remaining periods of amortization. Based on the evaluation, no changes to the remaining useful lives was required. Management performed an annual impairment test on core deposit intangibles as of September 30, 2018 and determined no impairment was necessary. Amortization expense recognized was \$455,000 for 2018, \$234,000 for 2017, and \$149,000 for 2016.

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

Years Ending December 31,	Estimated Core Deposit Intangible Amortization
2019	\$ 696
2020	696
2021	661
2022	453
2023	66
Thereafter	-
Total	\$ 2,572

8. DEPOSITS

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

	December 31,	
	2018	2017
Savings	\$ 114,565	\$ 116,534
Money market	267,820	299,638
NOW accounts	252,439	296,406
Time, \$250,000 or more	30,902	34,441
Time, under \$250,000	65,915	93,629
	<u>\$ 731,641</u>	<u>\$ 840,648</u>

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

Years Ending December 31,	
2019	\$ 71,869
2020	18,880
2021	2,437
2022	1,429
2023	1,092
Thereafter	1,110
	<u>\$ 96,817</u>

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

	Years Ended December 31,		
	2018	2017	2016
Savings	\$ 37	\$ 33	\$ 27
Money market	419	211	133
NOW accounts	414	317	290
Time certificates of deposit	283	408	525
	<u>\$ 1,153</u>	<u>\$ 969</u>	<u>\$ 975</u>

Notes to Consolidated Financial Statements

9. BORROWING ARRANGEMENTS

Federal Home Loan Bank Advances - As of December 31, 2018, the Company had \$10,000,000 in Federal Home Loan Bank (FHLB) of San Francisco advances. As of December 31, 2017, the Company had no FHLB advances.

Approximately \$447,757,000 in loans were pledged under a blanket lien as collateral to the FHLB for the Bank's remaining borrowing capacity of \$286,934,000 as of December 31, 2018. FHLB advances are also secured by investment securities with amortized costs totaling \$326,000 and \$416,000 and market values totaling \$337,000 and \$440,000 at December 31, 2018 and 2017, respectively. The Bank's credit limit varies according to the amount and composition of the investment and loan portfolios pledged as collateral.

Lines of Credit - The Bank had unsecured lines of credit with its correspondent banks which, in the aggregate, amounted to \$40,000,000 at December 31, 2018 and 2017, at interest rates which vary with market conditions. As of December 31, 2018 and 2017, the Company had no in Federal funds purchased.

Federal Reserve Line of Credit - The Bank has a line of credit in the amount of \$4,364,000 and \$6,740,000 with the Federal Reserve Bank of San Francisco (FRB) at December 31, 2018 and 2017, respectively, which bears interest at the prevailing discount rate collateralized by investment securities with amortized costs totaling \$4,498,000 and \$7,431,000 and market values totaling \$4,475,000 and \$7,437,000, respectively. At December 31, 2018 and 2017, the Bank had no outstanding borrowings with the FRB.

10. JUNIOR SUBORDINATED DEFERRABLE INTEREST DEBENTURES

Service 1st Capital Trust I is a Delaware business trust formed by Service 1st. The Company succeeded to all of the rights and obligations of Service 1st in connection with the merger with Service 1st as of November 12, 2008. The Trust was formed on August 17, 2006 for the sole purpose of issuing trust preferred securities fully and unconditionally guaranteed by Service 1st. Under applicable regulatory guidance, the amount of trust preferred securities that is eligible as Tier 1 capital is limited to 25% of the Company's Tier 1 capital on a pro forma basis. At December 31, 2018, all of the trust preferred securities that have been issued qualify as Tier 1 capital. The trust preferred securities mature on October 7, 2036, are redeemable at the Company's option, and require quarterly distributions by the Trust to the holder of the trust preferred securities at a variable interest rate which will adjust quarterly to equal the three month LIBOR plus 1.60%.

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

The Notes may be declared immediately due and payable at the election of the trustee or holders of 25% of the aggregate principal amount of outstanding Notes in the event that the Company defaults in the payment of any interest following the nonpayment of any such interest for 20 or more consecutive quarterly periods.

Holders of the trust preferred securities are entitled to a cumulative cash distribution on the liquidation amount of \$1,000 per security. For each January 7, April 7, July 7 or October 7 of each year, the rate will be adjusted to equal the three month LIBOR plus 1.60%. As of December 31, 2018, the rate was 4.04%. Interest expense recognized by the Company for the years ended December 31, 2018, 2017, and 2016 was \$199,000, \$147,000 and \$121,000, respectively.

11. INCOME TAXES

The provision for income taxes for the years ended December 31, 2018, 2017, and 2016 consisted of the following (in thousands):

	Federal	State	Total
<u>2018</u>			
Current	\$ 3,995	\$ 2,689	\$ 6,684
Deferred	<u>(140)</u>	<u>76</u>	<u>(64)</u>
Provision for income taxes	<u>\$ 3,855</u>	<u>\$ 2,765</u>	<u>\$ 6,620</u>
<u>2017</u>			
Current	\$ 1,188	\$ 1,224	\$ 2,412
Deferred	3,328	518	3,846
Re-measurement resulting from Tax Act	3,535	-	3,535
Provision for income taxes	<u>\$ 8,051</u>	<u>\$ 1,742</u>	<u>\$ 9,793</u>
<u>2016</u>			
Current	\$ 3,720	\$ 605	\$ 4,325
Deferred	1,100	1,492	2,592
Provision for income taxes	<u>\$ 4,820</u>	<u>\$ 2,097</u>	<u>\$ 6,917</u>

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is more likely than not that all or a portion of the deferred tax asset will not be realized. More likely than not is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of the evidence, a valuation allowance is needed. Thus, Management concludes no valuation allowance is necessary against deferred tax assets.

Notes to Consolidated Financial Statements

11. INCOME TAXES (Continued)

Deferred tax assets (liabilities) consisted of the following (in thousands):

	December 31,	
	2018	2017
Deferred tax assets:		
Allowance for credit losses	\$ 2,380	\$ 2,100
Deferred compensation	4,347	4,415
Unrealized loss on available-for-sale investment securities	1,850	-
Net operating loss carryovers	2,407	2,549
Mark-to-market adjustment	53	87
Other deferred tax assets	445	386
Other-than-temporary impairment	192	192
Loan and investment impairment	1,450	1,793
Partnership income	55	68
State taxes	575	375
Total deferred tax assets	13,754	11,965
Deferred tax liabilities:		
Finance leases	(173)	(365)
Unrealized gain on available-for-sale investment securities	-	(1,186)
Core deposit intangible	(760)	(895)
FHLB stock	(234)	(234)
Loan origination costs	(891)	(783)
Bank premises and equipment	(513)	(478)
Total deferred tax liabilities	(2,571)	(3,941)
Net deferred tax assets	<u>\$ 11,183</u>	<u>\$ 8,024</u>

The provision for income taxes differs from amounts computed by applying the statutory Federal income tax rates to operating income before income taxes. The significant items comprising these differences for the years ended December 31, 2018, 2017, and 2016 consisted of the following:

	2018	2017	2016
Federal income tax, at statutory rate	21.0 %	35.0 %	35.0 %
State taxes, net of Federal tax benefit	7.8 %	4.8 %	6.2 %
Tax exempt investment security income, net	(2.7)%	(10.1)%	(10.3)%
Bank owned life insurance, net	(0.6)%	(0.8)%	(1.1)%
Compensation—Stock Compensation	(0.6)%	(2.8)%	- %
Re-measurement resulting from Tax Act	- %	14.8 %	- %
Change in uncertain tax positions	(0.3)%	(0.9)%	0.1 %
Other	(0.9)%	1.1 %	1.4 %
Effective tax rate	<u>23.7 %</u>	<u>41.1 %</u>	<u>31.3 %</u>

As of December 31, 2018, the Company had Federal and California net operating loss ("NOL") carry-forwards of \$8,049,000 and \$8,372,000, respectively. These NOLs were acquired through business combinations and are subject to IRC 382 and begin expiring in 2028, for federal and California purposes. While they are subject to IRC Section 382, management has determined that all of the NOLs are more than likely than not to be utilized.

As a result of the enactment of the Tax Cuts and Jobs Act (the "Tax Act") on December 22, 2017, the federal tax rate applied to the Company's net deferred tax assets were re-measured to reflect the 2018 tax rates (the rates at which the deferred tax items are expected to reverse). The change to the tax rates (including the rate change applied to deferred taxes reflected in other comprehensive income and certain tax-advantaged investments as reflected in other assets) resulted in an increase to the Company's 2017 tax provision of \$3,535,000. As part of the Tax

Act for tax years beginning after December 31, 2017, alternative minimum tax credit carryforwards are and not dependent on future income. As such, they have been classified as a current tax receivable rather than a deferred tax asset. As of December 31, 2018, the alternative minimum tax credit carryforwards have been fully utilized. ASU 2016-09, "Compensation-Stock Compensation (718) Improvements to Employee Share-Based Payment Accounting" requires the Company to recognize all excess tax benefits or tax deficiencies through the income statement as income tax expense/benefit. A tax benefit of \$165,000 was recognized during the year ended December 31, 2018 and a benefit of \$853,000 was recognized during the year ended December 31, 2017.

The Company and its subsidiary file income tax returns in the U.S. federal and California jurisdictions. The Company conducts all of its business activities in the State of California. There are no pending U.S. federal or California Franchise Tax Board income tax examinations by those taxing authorities. The Company is no longer subject to the examination by U.S. federal taxing authorities for the years ended before December 31, 2015 and by the state and local taxing authorities for the years ended before December 31, 2014. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

	December 31,	
	2018	2017
Balance, beginning of year	\$ 83	\$ 298
Reductions due to the statute of limitations for tax positions of prior years	(83)	(215)
Balance, end of year	<u>\$ -</u>	<u>\$ 83</u>

As of December 31, 2018, the Company has no unrecognized tax benefits and does not expect this to change in the next 12 months.

During the years ended December 31, 2018 and 2017, the Company recorded no interest or penalties related to uncertain tax positions.

12. COMMITMENTS AND CONTINGENCIES

Leases - The Bank leases certain of its branch facilities and administrative offices under noncancelable operating leases. Rental expense included in occupancy and equipment and other expenses totaled \$2,735,000, \$2,533,000 and \$2,300,000 for the years ended December 31, 2018, 2017, and 2016, respectively.

Future minimum lease payments on noncancelable operating leases are as follows (in thousands):

Years Ending December 31,	
2019	\$ 2,384
2020	2,078
2021	1,805
2022	1,552
2023	1,448
Thereafter	<u>4,334</u>
	<u>\$ 13,601</u>

Federal Reserve Requirements - Banks are required to maintain reserves with the Federal Reserve Bank equal to a percentage of their reservable deposits. The amount of such reserve balances required at December 31, 2018 was \$14,858,000.

Correspondent Banking Agreements - The Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Uninsured deposits totaled \$372,000 at December 31, 2018.

Financial Instruments With Off-Balance-Sheet Risk - The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and standby letters of credit. These instruments

Notes to Consolidated Financial Statements

12. COMMITMENTS AND CONTINGENCIES (Continued)

involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet.

The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and standby letters of credit as it does for loans included on the balance sheet.

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

	December 31,	
	2018	2017
Commitments to extend credit	\$ 309,824	\$ 347,001
Standby letters of credit	\$ 2,450	\$ 3,140

Commitments to extend credit consist primarily of unfunded commercial loan commitments and revolving lines of credit, single-family residential equity lines of credit and commercial and residential real estate construction loans. Construction loans are established under standard underwriting guidelines and policies and are secured by deeds of trust, with disbursements made over the course of construction. Commercial revolving lines of credit have a high degree of industry diversification. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being fully drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are generally secured and are issued by the Bank to guarantee the financial obligation or performance of a customer to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to customers. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2018 and 2017. The Company recognizes these fees as revenue over the term of the commitment or when the commitment is used.

At December 31, 2018, commercial loan commitments represent 54% of total commitments and are generally secured by collateral other than real estate or unsecured. Real estate loan commitments represent 39% of total commitments and are generally secured by property with a loan-to-value ratio not to exceed 80%. Consumer loan commitments represent the remaining 7% of total commitments and are generally unsecured. In addition, the majority of the Bank's loan commitments have variable interest rates.

At December 31, 2018 and 2017, the balance of a contingent allocation for probable loan loss experience on unfunded obligations was \$225,000 and \$326,000, respectively. The contingent allocation for probable loan loss experience on unfunded obligations is calculated by management using an appropriate, systematic, and consistently applied process. While related to credit losses, this allocation is not a part of the ALLL and is considered separately as a liability for accounting and regulatory reporting purposes. Changes in this contingent allocation are recorded in other non-interest expense.

Concentrations of Credit Risk - At December 31, 2018, in management's judgment, a concentration of loans existed in commercial loans and real-estate-related loans, representing approximately 95.8% of total loans of which 12% were commercial and 83.8% were real-estate-related.

At December 31, 2017, in management's judgment, a concentration of loans existed in commercial loans and real-estate-related loans, representing approximately 96.6% of total loans of which 12.9% were commercial and 83.7% were real-estate-related.

Management believes the loans within these concentrations have no more than the typical risks of collectability. However, in light of the current economic environment, additional declines in the performance of the economy in general, or a continued decline in real estate values or drought-related decline in agricultural business in the Company's primary market area could have an adverse impact on collectability, increase the level of real-estate-related nonperforming loans, or have other adverse effects which alone or in the aggregate could have a

material adverse effect on the financial condition, results of operations and cash flows of the Company.

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

13. SHAREHOLDERS' EQUITY

Regulatory Capital - The Company and the Bank are subject to certain regulatory capital requirements administered by the Board of Governors of the Federal Reserve System and the FDIC. Failure to meet these minimum capital requirements could result in mandatory or, discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements.

The Company and the Bank each meet specific capital guidelines that involve quantitative measures of their respective assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

The Bank is also subject to additional capital guidelines under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. The most recent notification from the FDIC categorized the Bank as well capitalized under these guidelines. Management knows of no conditions or events since that notification that would change the Bank's category.

Capital ratios are reviewed by Management on a regular basis to ensure that capital exceeds the prescribed regulatory minimums and is adequate to meet our anticipated future needs. For all periods presented, the Bank's ratios exceed the regulatory definition of well capitalized under the regulatory framework for prompt correct action and the Company's ratios exceed the required minimum ratios for capital adequacy purposes.

Effective January 1, 2015, bank holding companies with consolidated assets of \$1 billion or more (\$3 Billion or more effective August 30, 2018) and banks like Central Valley Community Bank must comply with new minimum capital ratio requirements to be phased-in between January 1, 2015 and January 1, 2019, which consist of the following: (i) a new common equity Tier 1 capital to total risk weighted assets ratio of 4.5%; (ii) a Tier 1 capital to total risk weighted assets ratio of 6% (increased from 4%); (iii) a total capital to total risk weighted assets ratio of 8% (unchanged from current rules); and (iv) a Tier 1 capital to adjusted average total assets ("leverage") ratio of 4%.

In addition, a "capital conservation buffer" is established which, when fully phased-in, will require maintenance of a minimum of 2.5% of common equity Tier 1 capital to total risk weighted assets in excess of the regulatory minimum capital ratio requirements described above. The 2.5% buffer will increase the minimum capital ratios to (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. The new buffer requirement is being phased-in between January 1, 2016 and January 1, 2019. The capital conservation buffer as of December 31, 2018 was 1.875% and 1.250% as of December 31, 2017. If the capital ratio levels of a banking organization fall below the capital conservation buffer amount, the organization will be subject to limitations on (i) the payment of dividends; (ii) discretionary bonus payments; (iii) discretionary payments under Tier 1 instruments; and (iv) engaging in share repurchases.

Management believes that the Company and the Bank met all their capital adequacy requirements as of December 31, 2018 and 2017. There are no conditions or events since those notifications that management believes have changed those categories. The capital ratios for the Company and the Bank are presented in the table below (exclusive of the capital conservation buffer).

The following table presents the Company's and the Bank's actual capital ratios as of December 31, 2018 and December 31, 2017, as well as the minimum capital ratios for capital adequacy for the Bank.

Notes to Consolidated Financial Statements

13. SHAREHOLDERS' EQUITY (Continued)

(Dollars in thousands)	Actual Ratio		Minimum regulatory requirement (1)	
	Amount	Ratio	Amount	Ratio
December 31, 2018				
Tier 1 Leverage Ratio	\$ 171,149	11.48%	N/A	N/A
Common Equity Tier 1 Ratio (CET 1)	\$ 166,149	15.13%	N/A	N/A
Tier 1 Risk-Based Capital Ratio	\$ 171,149	15.59%	N/A	N/A
Total Risk-Based Capital Ratio	\$ 180,478	16.44%	N/A	N/A

December 31, 2017

Tier 1 Leverage Ratio	\$ 153,676	9.71%	\$ 63,338	4.00%
Common Equity Tier 1 Ratio (CET 1)	\$ 149,186	12.90%	\$ 52,081	5.75%
Tier 1 Risk-Based Capital Ratio	\$ 153,676	13.28%	\$ 69,441	7.25%
Total Risk-Based Capital Ratio	\$ 162,780	14.07%	\$ 92,588	9.25%

(1) The 2017 minimum regulatory requirement threshold includes the capital conservation buffer of 1.250%.

The following table presents the Bank's regulatory capital ratios as of December 31, 2018 and December 31, 2017.

(Dollars in thousands)	Actual Ratio		Minimum regulatory requirement (1)	
	Amount	Ratio	Amount	Ratio
December 31, 2018				
Tier 1 Leverage Ratio	\$ 168,770	11.32%	\$ 59,639	4.00%
Common Equity Tier 1 Ratio (CET 1)	\$ 168,770	15.38%	\$ 49,388	6.38%
Tier 1 Risk-Based Capital Ratio	\$ 168,770	15.38%	\$ 65,850	7.88%
Total Risk-Based Capital Ratio	\$ 178,099	16.23%	\$ 87,800	9.88%

December 31, 2017

Tier 1 Leverage Ratio	\$ 149,779	9.46%	\$ 63,332	4.00%
Common Equity Tier 1 Ratio (CET 1)	\$ 149,779	12.96%	\$ 52,040	5.75%
Tier 1 Risk-Based Capital Ratio	\$ 149,779	12.96%	\$ 69,387	7.25%
Total Risk-Based Capital Ratio	\$ 158,882	13.74%	\$ 92,516	9.25%

(1) The 2018 and 2017 minimum regulatory requirement threshold includes the capital conservation buffer of 1.250% and 0.625%, respectively. These ratios are not reflected on a fully phased-in basis, which will occur in January 2019.

Dividends - During 2018, the Bank declared and paid cash dividends to the Company in the amount of \$2,850,000 in connection with the cash dividends to the Company's shareholders approved by the Company's Board of Directors. The Company declared and paid a total of \$4,270,000 or \$0.31 per common share cash dividend to shareholders of record during the year ended December 31, 2018.

During 2017, the Bank declared and paid cash dividends to the Company in the amount of \$3,133,000, in connection with the cash dividends to the Company's shareholders approved by the Company's Board of Directors. The Company declared and paid a total of \$3,010,000 or \$0.24 per common share cash dividend to shareholders of record during the year ended December 31, 2017.

During 2016, the Bank declared and paid cash dividends to the Company in the amount of \$13,010,000, in connection with the SVB acquisition, and cash dividends approved by the Company's Board of Directors. The Company declared and paid a total of \$2,715,000 or \$0.24 per common share cash dividend to shareholders of record during the year ended December 31, 2016.

The Company's primary source of income with which to pay cash dividends is dividends from the Bank. The California Financial Code restricts the total amount of dividends payable by a bank at any time without obtaining the prior approval of the California Department of Business Oversight to the lesser of (1) the Bank's retained earnings or (2) the Bank's net income for its last three

fiscal years, less distributions made to shareholders during the same three-year period. At December 31, 2018, \$33,036,000 of the Bank's retained earnings were free of these restrictions.

A reconciliation of the numerators and denominators of the basic and diluted earnings per common share computations is as follows (in thousands, except share and per-share amounts):

	For the Years Ended December 31,		
	2018	2017	2016
Basic Earnings Per Common Share:			
Net income	\$ 21,289	\$ 14,026	\$ 15,182
Weighted average shares outstanding	13,699,823	12,472,095	11,331,166
Net income per common share	\$ 1.55	\$ 1.12	\$ 1.34
Diluted Earnings Per Common Share:			
Net income	\$ 21,289	\$ 14,026	\$ 15,182
Weighted average shares outstanding	13,699,823	12,472,095	11,331,166
Effect of dilutive stock options and warrants	129,171	250,255	104,283
Weighted average shares of common stock and common stock equivalents	13,828,994	12,722,350	11,435,449
Net income per diluted common share	\$ 1.54	\$ 1.10	\$ 1.33

No outstanding options and restricted stock awards were anti-dilutive at December 31, 2018, 2017, and 2016.

14. SHARED-BASED COMPENSATION

On December 31, 2018, the Company had five share-based compensation plans, which are described below. The Plans do not provide for the settlement of awards in cash and new shares are issued upon option exercise or restricted share grants.

The Central Valley Community Bancorp 2000 Stock Option Plan (2000 Plan) expired on November 15, 2010. The Central Valley Community Bancorp 2005 Omnibus Incentive Plan (2005 Plan) was adopted in May 2005 and expired March 16, 2015. While outstanding arrangements to issue shares under these plans, including options, continue in force until their expiration, no new options will be granted under these plans. The plans require that the exercise price may not be less than the fair market value of the stock at the date the option is granted, and that the option price must be paid in full at the time it is exercised. The options and awards under the plans expire on dates determined by the Board of Directors, but not later than ten years from the date of grant. The vesting period for the options, restricted common stock awards and option related stock appreciation rights is determined by the Board of Directors and is generally over five years.

In May 2015, the Company adopted the Central Valley Community Bancorp 2015 Omnibus Incentive Plan (2015 Plan). The plan provides for awards in the form of incentive stock options, non-statutory stock options, stock appreciation rights, and restricted stock. The plan also allows for performance awards that may be in the form of cash or shares of the Company, including restricted stock. The 2015 plan requires that the exercise price may not be less than the fair market value of the stock at the date the option is granted, and that the option price must be paid in full at the time it is exercised. The options and awards under the plan expire on dates determined by the Board of Directors, but not later than ten years from the date of grant. The vesting period for the options, restricted common stock awards and option related stock appreciation rights is determined by the Board of Directors and is over one to five years. The maximum number of shares that can be issued with respect to all awards under

Notes to Consolidated Financial Statements

14. SHARED-BASED COMPENSATION (Continued)

the plan is 875,000. Currently under the 2015 Plan, there are 809,996 shares remain reserved for future grants as of December 31, 2018.

Effective June 2, 2017, the Company adopted an Employee Stock Purchase Plan whereby our employees may purchase Company common shares through payroll deductions of between one percent and 15 percent of pay in each pay period. Shares are purchased at the end of an offering period at a discount of 10 percent from the lower of the closing market price on the Offering Date (first trading day of each offering period) or the Investment Date (last trading day of each offering period). The plan calls for 500,000 common shares to be set aside for employee purchases, and there were 485,978 shares available for future purchase under the plan as of December 31, 2018.

In October 2017, the Company adopted the Folsom Lake Bank 2007 Equity Incentive Plan (2007 Plan). The plan provides for awards in the form of incentive stock options, non-statutory stock options, stock appreciation rights, and restricted stock. While outstanding arrangements to issue shares under this plan, including options, continue in force until their expiration, no new options will be granted under this plan. The options and awards under the plan expire on dates determined by the Board of Directors, but not later than ten years from the date of grant. The vesting period for the options, restricted common stock awards and option related stock appreciation rights is determined by the Board of Directors and is generally over five years. The maximum number of shares that can be issued with respect to all awards under the plan is 313,360.

For the years ended December 31, 2018, 2017, and 2016, the compensation cost recognized for share-based compensation was \$482,000, \$384,000, and \$284,000, respectively. The recognized tax benefit for share-based compensation expense was \$142,000, \$805,000, and \$44,000 for 2018, 2017, and 2016, respectively.

Stock Options - The Company bases the fair value of the options granted on the date of grant using a Black-Scholes Merton option pricing model that uses assumptions based on expected option life and the level of estimated forfeitures, expected stock volatility, risk free interest rate, and dividend yield. The expected term and level of estimated forfeitures of the Company's options are based on the Company's own historical experience. Stock volatility is based on the historical volatility of the Company's stock. The risk-free rate is based on the U. S. Treasury yield curve for the periods within the contractual life of the options in effect at the time of grant. The compensation cost for options granted is based on the weighted average grant date fair value per share.

No options to purchase shares of the Company's common stock were granted during the years ending December 31, 2018, 2017 and 2016 from any of the Company's stock based compensation plans.

A summary of the combined activity of the Plans during the years then ended is presented below (dollars in thousands, except per-share amounts):

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Options outstanding at January 1, 2016	240,695	\$ 6.83		
Options exercised	(35,280)	\$ 6.55		
Options forfeited	(3,200)	\$ 8.77		
Options outstanding at December 31, 2016	202,215	\$ 6.87	3.26	\$ 2,647
Options assumed in acquisition	313,360	\$ 11.79		
Options exercised	(281,125)	\$ 10.47		
Options forfeited	(1,580)	\$ 8.11		
Options outstanding at December 31, 2017	232,870	\$ 9.13	2.87	\$ 2,574
Options exercised	(74,030)	\$ 9.97		
Options forfeited	(4,400)	\$ 10.85		
Options outstanding at December 31, 2018	154,440	\$ 8.68	2.81	\$ 1,554
Options vested or expected to vest at December 31, 2018	154,440	\$ 8.68	2.81	\$ 1,554
Options exercisable at December 31, 2018	154,440	\$ 8.68	2.81	\$ 1,554

Information related to the stock option plan during each year follows (in thousands):

	2018	2017	2016
Intrinsic value of options exercised	\$ 767	\$ 2,807	\$ 235
Cash received from options exercised	\$ 738	\$ 2,835	\$ 231
Excess tax benefit realized for option exercises	\$ 142	\$ 805	\$ 30

As of December 31, 2018, there is no unrecognized compensation cost related to stock options granted under all Plans. All options are fully vested. The total fair value of options vested was \$170,000 for the year ended December 31, 2017, respectively.

Restricted Common Stock Awards - The 2005 Plan and 2015 Plan provide for the issuance of shares to directors and officers. Restricted common stock grants typically vest over a one to five-year period. Restricted common stock (all of which are shares of our common stock) is subject to forfeiture if employment terminates prior to vesting. The cost of these awards is recognized over the vesting period of the awards based on the fair value of our common stock on the date of the grant.

Notes to Consolidated Financial Statements

14. SHARED-BASED COMPENSATION (Continued)

The following table presents the restricted common stock activity during the years presented:

	Shares	Weighted Average Grant Date	Fair Value
Nonvested outstanding shares at January 1, 2016	53,028	\$ 12.34	
Granted	54,650	\$ 14.10	
Vested	(12,438)	\$ 12.38	
Forfeited	(1,739)	\$ 12.95	
Nonvested outstanding shares at December 31, 2016	93,501	\$ 13.35	
Vested	(27,373)	\$ 13.34	
Forfeited	(2,360)	\$ 14.07	
Nonvested outstanding shares at December 31, 2017	63,768	\$ 13.33	
Granted	22,204	\$ 20.76	
Vested	(20,733)	\$ 13.09	
Forfeited	(1,710)	\$ 14.37	
Nonvested outstanding shares at December 31, 2018	<u>63,529</u>	<u>\$ 15.98</u>	

During the years ended December 31, 2018, 2017, and 2016, 22,204, 0, and 54,650 shares of restricted common stock were granted from outstanding grants under the 2005 and 2015 Plans. The restricted common stock had a weighted average fair value of \$20.76, and \$14.10 per share on the date of grant during the years ended December 31, 2018 and 2016, respectively. The shares awarded to employees and directors under the restricted stock agreements vest on applicable vesting dates only to the extent the recipient of the shares is then an employee or a director of the Company or one of its subsidiaries, and each recipient will forfeit all of the shares that have not vested on the date his or her employment or service is terminated.

As of December 31, 2018, there were 63,529 shares of restricted stock that are nonvested and expected to vest. Share-based compensation cost charged against income for restricted stock awards was \$459,000 for the year ended December 31, 2018, \$349,000 for the year ended December 31, 2017, and \$235,000 for the year ended December 31, 2016.

As of December 31, 2018, there was \$677,000 of total unrecognized compensation cost related to nonvested restricted common stock. Restricted stock compensation expense is recognized on a straight-line basis over the vesting period. This cost is expected to be recognized over a weighted average remaining period of 2.04 years and will be adjusted for subsequent changes in estimated forfeitures. Restricted common stock awards had an intrinsic value of \$1,308,000 at December 31, 2018.

15. EMPLOYEE BENEFITS

401(k) and Profit Sharing Plan - The Bank has established a 401(k) and profit sharing plan. The 401(k) plan covers substantially all employees who have completed a one-month employment period. Participants in the profit sharing plan are eligible to receive employer contributions after completion of 2 years of service. Bank contributions to the profit sharing plan are determined at the discretion of the Board of Directors. Participants are automatically vested 100% in all employer contributions. The Bank contributed \$900,000, \$600,000, and \$380,000 to the profit sharing plan in 2018, 2017, and 2016, respectively.

Additionally, the Bank may elect to make a matching contribution to the participants' 401(k) plan accounts. The amount to be contributed is announced by the Bank at the beginning of the plan year. For the years ended December 31, 2018, 2017, and 2016, the Bank made a 100% matching contribution on all deferred amounts up to 3% of eligible compensation and a 50% matching contribution on all deferred amounts above 3% to a maximum of 5%. For the years ended December 31, 2018, 2017, and 2016, the Bank made matching contributions totaling \$748,000, \$686,000, and \$604,000, respectively.

Deferred Compensation Plans - The Bank has a nonqualified Deferred Compensation Plan which provides directors with an unfunded, deferred compensation program. Under the plan, eligible participants may elect to defer some or all of their current compensation or director fees. Deferred amounts earn interest at an annual rate determined by the Board of Directors (3.12% at December 31, 2018). At December 31, 2018 and 2017, the total net deferrals included in accrued interest payable and other liabilities were \$3,842,000 and \$3,713,000, respectively.

In connection with the implementation of the above plan, single premium universal life insurance policies on the life of each participant were purchased by the Bank, which is the beneficiary and owner of the policies. The cash surrender value of the policies totaled \$9,436,000 and \$9,187,000 and at December 31, 2018 and 2017, respectively. Income recognized on these policies, net of related expenses, for the years ended December 31, 2018, 2017, and 2016, was \$249,000, \$255,000, and \$242,000, respectively.

In October 2015, the Board of Directors of the Company and the Bank adopted a board resolution to create the Central Valley Community Bank Executive Deferred Compensation Plan (the Executive Plan). Pursuant to the Executive Plan, all eligible executives of the Bank may elect to defer up to 50 percent of their compensation for each deferral year. Deferred amounts earn interest at an annual rate determined by the Board of Directors (3.12% at December 31, 2018). At December 31, 2018 and 2017, the total net deferrals included in accrued interest payable and other liabilities were \$129,000 and \$86,000, respectively.

Salary Continuation Plans - The Board of Directors has approved salary continuation plans for certain key executives. Under these plans, the Bank is obligated to provide the executives with annual benefits for 10-15 years after retirement. In connection with the acquisitions of Folsom Lake Bank (FLB), Service 1st Bank, and Visalia Community Bank (VCB), the Bank assumed a liability for the estimated present value of future benefits payable to former key executives of FLB, Service 1st, and VCB. The liability relates to change in control benefits associated with their salary continuation plans. The benefits are payable to the individuals when they reach retirement age. These benefits are substantially equivalent to those available under split-dollar life insurance policies purchased by the Bank on the life of the executives. The expense recognized under these plans for the years ended December 31, 2018, 2017, and 2016, totaled \$15,000, \$561,000, and \$489,000, respectively. Accrued compensation payable under the salary continuation plans totaled \$9,816,000 and \$5,786,000 at December 31, 2018 and 2017, respectively. These benefits are substantially equivalent to those available under split-dollar life insurance policies acquired.

In connection with these plans, the Bank purchased single-premium life insurance policies with cash surrender values totaling \$19,066,000 and \$18,620,000 at December 31, 2018 and 2017, respectively. Income recognized on these policies, net of related expense, for the years ended December 31, 2018, 2017, and 2016 totaled \$446,000, \$366,000, and \$316,000, respectively.

Employee Stock Purchase Plan - During 2017, the Company adopted an Employee Stock Purchase Plan which allows employees to purchase the Company's stock at a discount to fair market value as of the date of purchase. The Company bears all costs of administering the plan, including broker's fees, commissions, postage and other costs actually incurred.

16. LOANS TO RELATED PARTIES

During the normal course of business, the Bank enters into loans with related parties, including executive officers and directors. The following is a summary of the aggregate activity involving related-party borrowers (in thousands):

Balance, January 1, 2018	\$ 11,885
Disbursements	622
Amounts repaid	(769)
Balance, December 31, 2018	<u>\$ 11,738</u>
Undisbursed commitments to related parties, December 31, 2018	<u>\$ 1,442</u>

Notes to Consolidated Financial Statements

17. PARENT ONLY CONDENSED FINANCIAL STATEMENTS

CONDENSED BALANCE SHEETS

December 31, 2018 and 2017

(In thousands)

	2018	2017
ASSETS		
Cash and cash equivalents	\$ 2,326	\$ 3,296
Investment in Bank subsidiary	222,514	210,816
Other assets	367	750
Total assets	<u><u>\$ 225,207</u></u>	<u><u>\$ 214,862</u></u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Junior subordinated debentures due to subsidiary grantor trust	\$ 5,155	\$ 5,155
Other liabilities	314	148
Total liabilities	<u><u>5,469</u></u>	<u><u>5,303</u></u>
Shareholders' equity:		
Common stock	103,851	103,314
Retained earnings	120,294	103,419
Accumulated other comprehensive (loss) income, net of tax	(4,407)	2,826
Total shareholders' equity	<u><u>219,738</u></u>	<u><u>209,559</u></u>
Total liabilities and shareholders' equity	<u><u>\$ 225,207</u></u>	<u><u>\$ 214,862</u></u>

CONDENSED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

For the Years Ended December 31, 2018, 2017, and 2016

(In thousands)

	2018	2017	2016
Income:			
Dividends declared by Subsidiary - eliminated in consolidation	\$ 2,850	\$ 3,133	\$ 13,010
Other income	6	4	4
Total income	<u><u>2,856</u></u>	<u><u>3,137</u></u>	<u><u>13,014</u></u>
Expenses:			
Interest on junior subordinated deferrable interest debentures	199	147	121
Professional fees	217	231	133
Other expenses	548	1,019	779
Total expenses	<u><u>964</u></u>	<u><u>1,397</u></u>	<u><u>1,033</u></u>
Income before equity in undistributed net income of Subsidiary	1,892	1,740	11,981
Equity in undistributed net income of Subsidiary, net of distributions	19,075	11,754	2,852
Income before income tax benefit	20,967	13,494	14,833
Benefit from income taxes	322	532	349
Net income	<u><u>\$ 21,289</u></u>	<u><u>\$ 14,026</u></u>	<u><u>\$ 15,182</u></u>
Comprehensive income	<u><u>\$ 13,912</u></u>	<u><u>\$ 16,867</u></u>	<u><u>\$ 10,204</u></u>

Notes to Consolidated Financial Statements

17. PARENT ONLY CONDENSED FINANCIAL STATEMENTS (Continued)

CONDENSED STATEMENTS OF CASH FLOWS For the Years Ended December 31, 2018, 2017, and 2016 (In thousands)

	2018	2017	2016
Cash flows from operating activities:			
Net income	\$ 21,289	\$ 14,026	\$ 15,182
Adjustments to reconcile net income to net cash provided by operating activities:			
Undistributed net income of subsidiary, net of distributions	(19,075)	(11,754)	(2,852)
Stock-based compensation	482	384	284
Tax benefit from exercise of stock options	-	-	(30)
Net decrease (increase) in other assets	372	(114)	(405)
Net increase (decrease) in other liabilities	166	(7)	64
Benefit for deferred income taxes	11	155	98
Net cash provided by operating activities	<u>3,245</u>	<u>2,690</u>	<u>12,341</u>
Cash flows used in investing activities:			
Investment in subsidiary	-	(151)	(9,584)
Cash flows from financing activities:			
Cash dividend payments on common stock	(4,270)	(3,010)	(2,715)
Purchase and retirement of common stock	(894)	-	-
Proceeds from exercise of stock options	738	2,880	231
Proceeds from stock issued under employee stock purchase plan	211	-	-
Excess tax benefit from exercise of stock options	-	-	30
Net cash used in financing activities	<u>(4,215)</u>	<u>(130)</u>	<u>(2,454)</u>
(Decrease) increase in cash and cash equivalents	(970)	2,409	303
Cash and cash equivalents at beginning of year	<u>3,296</u>	<u>887</u>	<u>584</u>
Cash and cash equivalents at end of year	<u>\$ 2,326</u>	<u>\$ 3,296</u>	<u>\$ 887</u>
Supplemental Disclosure of Cash Flow Information:			
Cash paid during the year for interest	\$ 185	\$ 142	\$ 112
Non-cash investing and financing activities:			
Common stock issued in acquisitions	\$ -	\$ 28,405	\$ 16,678

Supplementary Financial Information

The following supplementary financial information is not a part of the Company's financial statements.

Unaudited Quarterly Statement of Operations Data
(In thousands, except per share amounts)

	Q4 2018	Q3 2018	Q2 2018	Q1 2018	Q4 2017	Q3 2017	Q2 2017	Q1 2017
Net interest income	\$ 15,973	\$ 15,907	\$ 15,397	\$ 15,426	\$ 15,567	\$ 13,578	\$ 13,786	\$ 13,308
Provision for (Reversal of) credit losses	-	-	50	-	-	(900)	(150)	(100)
Net interest income after provision for credit losses	15,973	15,907	15,347	15,426	15,567	14,478	13,936	13,408
Other non-interest income	2,367	2,083	2,604	1,956	1,947	2,385	1,939	1,763
Net realized gains (losses) on investment securities	37	380	82	815	(6)	169	2,157	482
Total non-interest expense	11,410	10,791	11,499	11,368	13,109	10,394	10,789	10,114
Provision for income taxes	1,686	1,827	1,569	1,538	4,064	2,144	2,295	1,290
Net income	\$ 5,281	\$ 5,752	\$ 4,965	\$ 5,291	\$ 335	\$ 4,494	\$ 4,948	\$ 4,249
Basic earnings per share	\$ 0.38	\$ 0.42	\$ 0.36	\$ 0.39	\$ 0.02	\$ 0.37	\$ 0.41	\$ 0.35
Diluted earnings per share	\$ 0.38	\$ 0.42	\$ 0.36	\$ 0.39	\$ 0.02	\$ 0.36	\$ 0.40	\$ 0.35

The results for the fourth quarter 2017 include the results of the assets and liabilities acquired from Folsom Lake Bank in addition to the continued organic growth of the Company. The Company recorded additional tax expense of \$3.54 million in the fourth quarter of 2017 related to the Tax Cuts and Jobs Act, which required the Company to re-measure its net deferred tax assets and resulted in a reduction in diluted earnings per share of \$0.26 in the quarter and \$0.28 for the year.

Financial Statements and Supplementary Data.

Report of Independent Registered Public Accounting Firm

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

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Central Valley Community Bancorp and Subsidiary (the "Company") as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively referred to as the "financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control—Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2018 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control—Integrated Framework: (2013) issued by COSO.

Basis for Opinions

The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

We have served as the Company's auditor since 2011.

Crowe LLP

Sacramento, California

March 8, 2019

Selected Consolidated Financial Data

Years Ended December 31,
(In thousands, except per-share amounts)

Statements of Income	2018	2017	2016	2015	2014
Total interest income	\$ 64,187	\$ 57,376	\$ 46,676	\$ 41,822	\$ 41,039
Total interest expense	<u>1,484</u>	<u>1,137</u>	<u>1,096</u>	<u>1,047</u>	<u>1,156</u>
Net interest income before provision for credit losses	62,703	56,239	45,580	40,775	39,883
Provision for (reversal of) credit losses	<u>50</u>	<u>(1,150)</u>	<u>(5,850)</u>	<u>600</u>	<u>7,985</u>
Net interest income after provision for credit losses	62,653	57,389	51,430	40,175	31,898
Non-interest income	10,324	10,836	9,591	9,387	8,164
Non-interest expenses	<u>45,068</u>	<u>44,406</u>	<u>38,922</u>	<u>36,016</u>	<u>35,338</u>
Income before provision for (benefit from) income taxes	27,909	23,819	22,099	13,546	4,724
Provision for (benefit from) income taxes	<u>6,620</u>	<u>9,793</u>	<u>6,917</u>	<u>2,582</u>	<u>(570)</u>
Net income	<u>\$ 21,289</u>	<u>\$ 14,026</u>	<u>\$ 15,182</u>	<u>\$ 10,964</u>	<u>\$ 5,294</u>
Basic earnings per share	<u>\$ 1.55</u>	<u>\$ 1.12</u>	<u>\$ 1.34</u>	<u>\$ 1.00</u>	<u>\$ 0.48</u>
Diluted earnings per share	<u>\$ 1.54</u>	<u>\$ 1.10</u>	<u>\$ 1.33</u>	<u>\$ 1.00</u>	<u>\$ 0.48</u>
Cash dividends declared per common share	<u>\$ 0.31</u>	<u>\$ 0.24</u>	<u>\$ 0.24</u>	<u>\$ 0.18</u>	<u>\$ 0.20</u>
		December 31, (In thousands)			
Balances at end of year:	2018	2017	2016	2015	2014
Investment securities, Federal funds sold and deposits in other banks	\$ 477,932	\$ 604,801	\$ 558,132	\$ 580,544	\$ 520,511
Net loans	909,591	891,901	747,302	588,501	564,280
Total deposits	1,282,298	1,425,687	1,255,979	1,116,267	1,039,152
Total assets	1,537,836	1,661,655	1,443,323	1,276,736	1,192,183
Shareholders' equity	219,738	209,559	164,033	139,323	131,045
Earning assets	1,406,987	1,505,436	1,319,065	1,173,591	1,074,942
Average balances:					
Investment securities, Federal funds sold and deposits in other banks	\$ 526,606	\$ 568,426	\$ 560,860	\$ 529,046	\$ 513,866
Net loans	903,204	784,085	636,475	577,784	531,382
Total deposits	1,333,754	1,284,305	1,144,231	1,065,798	1,006,560
Total assets	1,577,410	1,491,696	1,321,007	1,222,526	1,157,483
Shareholders' equity	211,324	182,507	154,325	135,062	130,414
Earning assets	1,435,025	1,358,930	1,205,142	1,112,758	1,052,097

Data from 2017 reflects the partial year impact of the acquisition of Folsom Lake Bank on October 1, 2017. Data from 2016 reflects the partial year impact of the acquisition of Sierra Vista Bank on October 1, 2016.

Management's Discussion and Analysis

of Financial Condition and Results of Operations.

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

Certain matters discussed in this report constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements contained herein that are not historical facts, such as statements regarding the Company's current business strategy and the Company's plans for future development and operations, are based upon current expectations. These statements are forward-looking in nature and involve a number of risks and uncertainties. Such risks and uncertainties include, but are not limited to (1) significant increases in competitive pressure in the banking industry; (2) the impact of changes in interest rates; (3) a decline in economic conditions in the Central Valley; (4) the Company's ability to continue its internal growth at historical rates; (5) the Company's ability to maintain its net interest margin; (6) the decline quality of the Company's earning assets; (7) decline in credit quality; (8) changes in the regulatory environment; (9) fluctuations in the real estate market; (10) changes in business conditions and inflation; (11) changes in securities markets (12) risks associated with acquisitions, relating to difficulty in integrating combined operations and related negative impact on earnings, and incurrence of substantial expenses. Therefore, the information set forth in such forward-looking statements should be carefully considered when evaluating the business prospects of the Company.

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

We are not able to predict all the factors that may affect future results. You should not place undue reliance on any forward looking statement, which speaks only as of the date of this Report on Form 10-K. Except as required by applicable laws or regulations, we do not undertake any obligation to update or revise any forward looking statement, whether as a result of new information, future events or otherwise.

INTRODUCTION

Central Valley Community Bancorp (NASDAQ: CVCY) (the Company) was incorporated on February 7, 2000. The formation of the holding company offered the Company more flexibility in meeting the long-term needs of customers, shareholders, and the communities it serves. The Company currently has one bank subsidiary, Central Valley Community Bank (the Bank) and one business trust subsidiary, Service 1st Capital Trust 1. The Company's market area includes the central valley area from Sacramento, California to Bakersfield, California.

During 2018, we focused on asset quality and capital adequacy due to the uncertainty created by the economy. We also focused on assuring that competitive products and services were made available to our clients while adjusting to the many new laws and regulations that affect the banking industry.

As of December 31, 2018, the Bank operated 21 full-service offices. The Bank has a Real Estate Division, an Agribusiness Center and an SBA Lending Division in Fresno. The Real Estate Division processes or assists in processing the majority of the Bank's real estate related transactions, including interim construction loans for single family residences and commercial buildings. We offer permanent single family residential loans through our mortgage broker services.

ECONOMIC CONDITIONS

Over the last several years the economy, as evidenced by the California and Central Valley unemployment rates, and housing prices have shown slow but

steady improvement. Housing in the Central Valley continues to be relatively more affordable than the major metropolitan areas in California.

Agriculture and agricultural related businesses remain a critical part of the Central Valley's economy. The Valley's agricultural production is widely diversified, producing nuts, vegetables, fruit, cattle, dairy products, and cotton. The continued future success of agriculture related businesses is highly dependent on the availability of water and is subject to fluctuation in worldwide commodity prices, currency exchanges, and demand. From time to time, California experiences severe droughts or adverse weather issues, which could significantly harm the business of our customers and the credit quality of the loans to those customers. We closely monitor the water resources and the related issues affecting our customers, and will remain vigilant for signs of deterioration within the loan portfolio in an effort to manage credit quality and work with borrowers where possible to mitigate any losses.

An additional negative affect on the agricultural is the "Tariff War", especially with China. The increased tariffs on agricultural products by China has an adverse effect on demand potentially causing financial difficulty for farmers. We are closely monitoring how the agricultural industry is adapting through developing new markets for their products.

OVERVIEW

Diluted earnings per share (EPS) for the year ended December 31, 2018 was \$1.54 compared to \$1.10 and \$1.33 for the years ended December 31, 2017 and 2016, respectively. Net income for 2018 was \$21,289,000 compared to \$14,026,000 and \$15,182,000 for the years ended December 31, 2017 and 2016, respectively. The increase in net income and EPS was primarily driven by the increase in net interest income and decrease in provision for income taxes, offset by the increase in non-interest expense, increase in provision for credit losses, and decrease in non-interest income in 2018 compared to 2017. Total assets at December 31, 2018 were \$1,537,836,000 compared to \$1,661,655,000 at December 31, 2017.

Return on average equity for 2018 was 10.07% compared to 7.69% and 9.84% for 2017 and 2016, respectively. Return on average assets for 2018 was 1.35% compared to 0.94% and 1.15% for 2017 and 2016, respectively. Total equity was \$219,738,000 at December 31, 2018 compared to \$209,559,000 at December 31, 2017. The increase in equity in 2018 compared to 2017 was primarily driven by the retention of earnings, net of dividends paid, offset by a decrease in unrealized gains on available-for-sale securities, net of estimated taxes, recorded in accumulated other comprehensive income (AOCI).

Average total loans increased \$118,785,000 or 14.97% to \$912,128,000 in 2018 compared to \$793,343,000 in 2017. In 2018, we recorded a provision for credit losses of \$50,000 compared to a reverse provision of \$1,150,000 in 2017 and a reverse provision of \$5,850,000 in 2016. The Company had nonperforming assets consisting of \$2,740,000 in nonaccrual loans at December 31, 2018. At December 31, 2017, nonperforming assets totaled \$2,945,000. Net loan loss recoveries for 2018 were \$276,000 compared to \$602,000 for 2017 and \$5,566,000 for 2016. Refer to "Asset Quality" below for further information.

Dividend Declared

On January 23, 2019, the Board of Directors declared a \$0.10 per share cash dividend payable on February 23, 2019 to shareholders of record as of February 8, 2019.

Key Factors in Evaluating Financial Condition and Operating Performance

In evaluating our financial condition and operating performance, we focus on several key factors including:

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

Management's Discussion and Analysis

of Financial Condition and Results of Operations.

OVERVIEW (Continued)

- Operating efficiency; and
- Liquidity.

Return to Our Shareholders

One measure of our return to our shareholders is the return on average equity (ROE). ROE is a ratio that measures net income divided by average shareholders' equity. Our ROE was 10.07% for the year ended 2018 compared to 7.69% and 9.84% for the years ended 2017 and 2016, respectively.

Our net income for the year ended December 31, 2018 increased \$7,263,000 compared to 2017 and decreased \$1,156,000 in 2017 compared to 2016. During 2018, net income compared to 2017 was positively impacted by the decrease in tax expense. 2017 was negatively impacted by the re-measurement of our deferred tax asset and corresponding increase in tax expense. Also contributing to the increase during 2018 was an increase in net interest income, partially offset by an increase in the provision for credit losses, an increase in non-interest expense and a decrease in non-interest income.

Net interest income increased primarily because of increases in loan and investment income, offset by increases in interest expense on deposits. The impact to interest income from the accretion of the loan marks on acquired loans was an increase of \$1,158,000 and \$1,048,000 for the years ended December 31, 2018 and 2017, respectively. For 2018, our net interest margin (NIM) increased four basis points to 4.44% compared to 2017. Our net interest margin increased as a result of yield changes, increase in interest rates, asset mix changes, and an increase in average earning assets. The increase in net interest margin in the period-to-period comparison resulted primarily from the increase in the effective yield on interest earning deposits in other banks and Federal Funds sold, offset by the decrease in the effective yield on average investment securities, and the decrease in the yield on the Company's loan portfolio. Net interest income during 2018 was positively impacted by the collection of nonaccrual loans which resulted in a recovery of interest income of approximately \$720,000. The recovery was partially offset by reversal of approximately \$222,000 in interest income on loans placed on nonaccrual during the year. Net interest income during 2017 was positively impacted by the collection of nonaccrual loans which resulted in a net recovery of interest income of approximately \$1,325,000. The recovery in 2017 was partially offset by reversal of approximately \$12,000 in interest income on loans placed on nonaccrual during the year.

Non-interest income decreased 4.72% in 2018 compared to 2017 primarily due to a \$1,488,000 decrease in net realized gains on sales and calls of investment securities and a decrease in service charge income of \$67,000. The decrease in non-interest income was offset by a net gain of \$462,000 on the sale of the Company's credit card portfolio, an increase in appreciation in cash surrender value of bank owned life insurance of \$74,000, and a \$147,000 increase in Federal Home Loan Bank dividends.

Non-interest expenses increased \$662,000 or 1.49% to \$45,068,000 in 2018 compared to \$44,406,000 in 2017. The net increase year over year was primarily attributable to the FLB acquisition, which resulted in increases in salaries and employee benefits of \$1,483,000, occupancy and equipment expenses of \$786,000, operating losses of \$302,000, information technology of \$295,000, advertising fees of \$120,000, and amortization of core deposit intangibles of \$221,000, offset by decrease in acquisition and integration expenses of \$1,611,000, a decrease of \$124,000 in credit card expenses, a decrease of \$132,000 in directors' expenses, and a decrease of \$74,000 in data processing expenses, in 2018 compared to 2017. The Company recorded an income tax provision of \$6,620,000 for the year ended December 31, 2018, compared to \$9,793,000 for the year ended December 31, 2017. The Company recognized additional tax expense in 2017 in the amount of \$3,535,000 related to a tax law change enacted in 2017. Basic EPS was \$1.55 for 2018 compared to \$1.12 and \$1.34 for 2017 and 2016, respectively. Diluted EPS was \$1.54 for 2018 compared to \$1.10 and \$1.33 for 2017 and 2016, respectively. The increase in EPS for 2018 is primarily due to the increase in net income.

Return on Average Assets

Our return on average assets (ROA) is a ratio that measures our performance compared with other banks and bank holding companies. Our ROA for the year

ended 2018 was 1.35% compared to 0.94% and 1.15% for the years ended December 31, 2017 and 2016, respectively. The 2018 increase in ROA is primarily due to the increase in net income. Annualized ROA for our peer group was 1.31% at December 31, 2018. Peer group information from SNL Financial data includes bank holding companies in central California with assets from \$600 million to \$3.5 billion.

Development of Revenue Streams

Over the past several years, we have focused on not only our net income, but improving the consistency of our revenue streams in order to create more predictable future earnings and reduce the effect of changes in our operating environment on our net income. Specifically, we have focused on net interest income through a variety of strategies, including increases in average interest earning assets, and minimizing the effects of the recent interest rate changes on our net interest margin by focusing on core deposits and managing the cost of funds. Our net interest margin (fully tax equivalent basis) was 4.44% for the year ended December 31, 2018, compared to 4.40% and 4.06% for the years ended December 31, 2017 and 2016, respectively. We experienced an increase in 2018 net interest margin compared to 2017, resulting from the increase in the effective yield on interest earning deposits in other banks and Federal Funds sold, offset by the decrease in the effective yield on average investment securities, and the decrease in the yield on the Company's loan portfolio. The effective tax equivalent yield on total earning assets increased six basis points, while the cost of total interest-bearing liabilities increased slightly to 0.19% for the year ended December 31, 2018. Our cost of total deposits in 2018 and 2017 was 0.09% and 0.08%, respectively, compared to 0.09% for the same period in 2016. Our net interest income before provision for credit losses increased \$6,464,000 or 11.49% to \$62,703,000 for the year ended 2018 compared to \$56,239,000 and \$45,580,000 for the years ended 2017 and 2016, respectively.

Our non-interest income is generally made up of service charges and fees on deposit accounts, fee income from loan placements, appreciation in cash surrender value of bank owned life insurance, and net gains from sales and calls of investment securities. Non-interest income in 2018 decreased \$512,000 or 4.72% to \$10,324,000 compared to \$10,836,000 in 2017 and \$9,591,000 in 2016. The decrease resulted primarily from decreases in net realized gains on sales and calls of investment securities and service charge income, partially offset by an increase in loan placement fees, net gain on the sale of the Company's credit card portfolio, interchange fees, appreciation in cash surrender value of bank owned life insurance, and Federal Home Loan Bank dividends compared to 2017. Further detail on non-interest income is provided below.

Asset Quality

For all banks and bank holding companies, asset quality has a significant impact on the overall financial condition and results of operations. Asset quality is measured in terms of classified and nonperforming loans, and is a key element in estimating the future earnings of a company. Total nonperforming assets were \$2,740,000 and \$2,945,000 at December 31, 2018 and 2017, respectively. Nonperforming assets totaled 0.30% of gross loans as of December 31, 2018 and 0.33% of gross loans as of December 31, 2017. Nonperforming loans were \$2,740,000 and \$2,875,000 at December 31, 2018 and 2017, respectively. The Company had no other real estate owned at December 31, 2018, December 31, 2017, and December 31, 2016. The carrying value of foreclosed assets was \$70,000 at December 31, 2017, and is included in other assets on the consolidated balance sheets. No foreclosed assets were recorded at December 31, 2018 or December 31, 2016. Management maintains certain loans that have been brought current by the borrower (less than 30 days delinquent) on nonaccrual status until such time as management has determined that the loans are likely to remain current in future periods.

The ratio of nonperforming loans to total loans was 0.30% as of December 31, 2018 and 0.32% as of December 31, 2017. The allowance for credit losses as a percentage of outstanding loan balance was 0.99% as of December 31, 2018 and 0.98% as of December 31, 2017. The ratio of net recoveries to average loans was 0.03% as of December 31, 2018 and 0.08% as of December 31, 2017.

Management's Discussion and Analysis

of Financial Condition and Results of Operations.

OVERVIEW (Continued)

Asset Growth

As revenues from both net interest income and non-interest income are a function of asset size, the continued growth in assets has a direct impact in increasing net income and therefore ROE and ROA. The majority of our assets are loans and investment securities, and the majority of our liabilities are deposits, and therefore the ability to generate deposits as a funding source for loans and investments is fundamental to our asset growth. Total assets decreased 7.45% during 2018 to \$1,537,836,000 as of December 31, 2018 from \$1,661,655,000 as of December 31, 2017. Total gross loans increased 2.00% to \$918,695,000 as of December 31, 2018, compared to \$900,679,000 at December 31, 2017. Total investment securities and Federal funds sold decreased 13.18% to \$471,207,000 as of December 31, 2018 compared to \$542,721,000 as of December 31, 2017. Total deposits decreased 10.06% to \$1,282,298,000 as of December 31, 2018 compared to \$1,425,687,000 as of December 31, 2017. Our loan to deposit ratio at December 31, 2018 was 71.64% compared to 63.18% at December 31, 2017. The loan to deposit ratio of our peers was 82.00% at December 31, 2018. Peer group information from S&P Global Market Intelligence data includes bank holding companies in central California with assets from \$600 million to \$3.5 billion.

Capital Adequacy

At December 31, 2018, we had a total capital to risk-weighted assets ratio of 16.44%, a Tier 1 risk-based capital ratio of 15.59%, common equity Tier 1 ratio of 15.13%, and a leverage ratio of 11.48%. At December 31, 2017, we had a total capital to risk-weighted assets ratio of 14.07%, a Tier 1 risk-based capital ratio of 13.28%, common equity Tier 1 ratio of 12.90%, and a leverage ratio of 9.71%. At December 31, 2018, on a stand-alone basis, the Bank had a total risk-based capital ratio of 16.23%, a Tier 1 risk based capital ratio of 15.38%, common equity Tier 1 ratio of 15.38%, and a leverage ratio of 11.32%. At December 31, 2017, the Bank had a total risk-based capital ratio of 13.74%, Tier 1 risk-based capital of 12.96% and a leverage ratio of 9.46%. Note 13 of the audited Consolidated Financial Statements provides more detailed information concerning the Company's capital amounts and ratios. As of January 1, 2015, bank holding companies with consolidated assets of \$1 billion or more (\$3 Billion or more effective August 30, 2018) and banks like Central Valley Community Bank became subject to new capital requirements, and certain provisions of the new rules are being phased in through 2019 under the Dodd-Frank Act and Basel III. As of December 31, 2018, the Bank met or exceeded all of their capital requirements inclusive of the capital buffer. The Bank's capital ratios exceeded the regulatory guidelines for a well-capitalized financial institution under the Basel III regulatory requirements at December 31, 2018.

Operating Efficiency

Operating efficiency is the measure of how efficiently earnings before taxes are generated as a percentage of revenue. A lower ratio represents greater efficiency. The Company's efficiency ratio (operating expenses, excluding amortization of intangibles and foreclosed property expense, divided by net interest income plus non-interest income, excluding net gains and losses from sale of securities) was 61.23% for 2018 compared to 62.03% for 2017 and 64.72% for 2016. The improvement in the efficiency ratios in 2018 and 2017 was due to the growth in revenues outpacing the growth in non-interest expense. The Company's net interest income before provision for credit losses plus non-interest income increased 8.87% to \$73,027,000 in 2018 compared to \$67,075,000 in 2017 and \$55,171,000 in 2016, while operating expenses increased 1.49% in 2018, 14.09% in 2017, and 8.07% in 2016.

Liquidity

Liquidity management involves our ability to meet cash flow requirements arising from fluctuations in deposit levels and demands of daily operations, which include providing for customers' credit needs, funding of securities purchases, and ongoing repayment of borrowings. Our liquidity is actively managed on a daily basis and reviewed periodically by our management and Directors' Asset/Liability Committee. This process is intended to ensure the maintenance of sufficient funds to meet our needs, including adequate cash flows for off-balance sheet commitments. Our primary sources of liquidity are derived from financing activities which include the acceptance of customer and, to a lesser extent, broker deposits, Federal funds facilities and advances from the Federal Home Loan Bank of San Francisco. We have available unsecured lines of credit with correspondent banks totaling approximately \$40,000,000 and secured borrowing lines of approximately \$286,934,000 with the Federal Home Loan Bank. These funding sources are augmented by collection of principal and interest on loans, the routine maturities and pay downs of securities from our investment securities portfolio, the stability of our core deposits, and the ability to sell investment securities. Primary uses of funds include origination and purchases of loans, withdrawals of and interest payments on deposits, purchases of investment securities, and payment of operating expenses.

We had liquid assets (cash and due from banks, interest-earning deposits in other banks, Federal funds sold, equity securities, and available-for-sale securities) totaling \$502,886,000 or 32.70% of total assets at December 31, 2018 and \$643,087,000 or 38.70% of total assets as of December 31, 2017.

RESULTS OF OPERATIONS

NET INCOME

Net income was \$21,289,000 in 2018 compared to \$14,026,000 and \$15,182,000 in 2017 and 2016, respectively. Basic earnings per share was \$1.55, \$1.12, and \$1.34 for 2018, 2017, and 2016, respectively. Diluted earnings per share was \$1.54, \$1.10, and \$1.33 for 2018, 2017, and 2016, respectively. ROE was 10.07% for 2018 compared to 7.69% for 2017 and 9.84% for 2016. ROA for 2018 was 1.35% compared to 0.94% for 2017 and 1.15% for 2016.

The increase in net income for 2018 compared to 2017 was primarily due to a decrease in provision for income taxes and an increase in net interest income, partially offset by an increase in the provision for credit losses, an increase in non-interest expense and a decrease in non-interest income. The decrease in net income for 2017 compared to 2016 was primarily attributed to an increase in provision for income taxes and an increase in non-interest expense, partially offset by an increase in the provision for credit losses, an increase in net interest income, and an increase in non-interest income.

INTEREST INCOME AND EXPENSE

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

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

Management's Discussion and Analysis

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INTEREST INCOME AND EXPENSE (Continued)

SCHEDULE OF AVERAGE BALANCES, AVERAGE YIELDS AND RATES (Dollars in thousands)	Year Ended December 31, 2018			Year Ended December 31, 2017			Year Ended December 31, 2016		
	Average Balance	Interest Income/ Expense	Average Interest Rate	Average Balance	Interest Income/ Expense	Average Interest Rate	Average Balance	Interest Income/ Expense	Average Interest Rate
ASSETS									
Interest-earning deposits in other banks	\$ 24,055	\$ 459	1.91%	\$ 36,709	\$ 424	1.16%	\$ 53,514	\$ 289	0.54%
Securities									
Taxable securities	391,549	10,254	2.62%	310,876	6,526	2.10%	313,006	5,876	1.88%
Non-taxable securities (1)	110,962	4,478	4.04%	220,806	10,443	4.73%	194,224	9,787	5.04%
Total investment securities	502,511	14,732	2.93%	531,682	16,969	3.19%	507,230	15,663	3.09%
Federal funds sold	40	1	2.10%	35	-	1.50%	116	-	0.51%
Total securities and interest-earning deposits	526,606	15,192	2.88%	568,426	17,393	3.06%	560,860	15,952	2.84%
Loans (2) (3)	908,419	49,936	5.50%	790,504	43,534	5.51%	644,282	34,051	5.29%
Total interest-earning assets	1,435,025	\$ 65,128	4.54%	1,358,930	\$ 60,927	4.48%	1,205,142	\$ 50,003	4.15%
Allowance for credit losses	(8,924)			(9,258)			(10,098)		
Nonaccrual loans	3,709			2,839			2,291		
Cash and due from banks	27,199			24,989			23,840		
Bank premises and equipment	9,148			9,310			9,053		
Other assets	111,253			104,886			90,779		
Total average assets	\$ 1,577,410			\$ 1,491,696			\$ 1,321,007		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Interest-bearing liabilities:									
Savings and NOW accounts	\$ 383,667	\$ 451	0.12%	\$ 382,071	\$ 350	0.09%	\$ 337,804	\$ 317	0.09%
Money market accounts	285,568	419	0.15%	264,581	211	0.08%	249,620	133	0.05%
Time certificates of deposit	111,214	283	0.25%	137,666	408	0.30%	139,656	525	0.38%
Total interest-bearing deposits	780,449	1,153	0.15%	784,318	969	0.12%	727,080	975	0.13%
Other borrowed funds	12,180	331	2.72%	6,930	168	2.42%	5,157	121	2.35%
Total interest-bearing liabilities	792,629	\$ 1,484	0.19%	791,248	\$ 1,137	0.14%	732,237	\$ 1,096	0.15%
Non-interest bearing demand deposits	553,305			499,987			417,151		
Other liabilities	20,152			17,954			17,294		
Shareholders' equity	211,324			182,507			154,325		
Total average liabilities and shareholders' equity	\$ 1,577,410			\$ 1,491,696			\$ 1,321,007		
Interest income and rate earned on average earning assets	\$ 65,128	<u>4.54%</u>		\$ 60,927	<u>4.48%</u>		\$ 50,003	<u>4.15%</u>	
Interest expense and interest cost related to average interest-bearing liabilities		<u>1,484</u>	<u>0.19%</u>		<u>1,137</u>	<u>0.14%</u>		<u>1,096</u>	<u>0.15%</u>
Net interest income and net interest margin (4)	\$ 63,644	<u>4.44%</u>		\$ 59,790	<u>4.40%</u>		\$ 48,907	<u>4.06%</u>	

(1) Interest income is calculated on a fully tax equivalent basis, which includes Federal tax benefits relating to income earned on municipal bonds totaling \$940, \$3,551, and \$3,327 in 2018, 2017, and 2016, respectively.

(2) Loan interest income includes loan fees of \$397 in 2018, \$684 in 2017, and \$134 in 2016.

(3) Average loans do not include nonaccrual loans.

(4) Net interest margin is computed by dividing net interest income by total average interest-earning assets.

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INTEREST INCOME AND EXPENSE (Continued)

The following table sets forth a summary of the changes in interest income and interest expense due to changes in average asset and liability balances (volume) and changes in average interest rates for the periods indicated. The change in interest due to both rate and volume has been allocated to the change in rate.

Changes in Volume/Rate	For the Years Ended December 31, 2018 Compared to 2017			For the Years Ended December 31, 2017 Compared to 2016		
	Volume	Rate	Net	Volume	Rate	Net
	(In thousands)					
Increase (decrease) due to changes in:						
Interest income:						
Interest-earning deposits in other banks	\$ (146)	\$ 181	\$ 35	\$ (90)	\$ 225	\$ 135
Investment securities:						
Taxable	1,694	2,034	3,728	(39)	689	650
Non-taxable (1)	(5,196)	(769)	(5,965)	1,339	(683)	656
Total investment securities	(3,502)	1,265	(2,237)	1,300	6	1,306
Federal funds sold	1	-	1	-	-	-
Loans	6,493	(91)	6,402	7,728	1,755	9,483
FHLB Stock	-	-	-	123	(310)	(187)
Total earning assets (1)	2,846	1,355	4,201	9,061	1,676	10,737
Interest expense:						
Deposits:						
Savings, NOW and MMA	17	292	309	49	62	111
Time certificate of deposits	(78)	(47)	(125)	(7)	(110)	(117)
Total interest-bearing deposits	(61)	245	184	42	(48)	(6)
Other borrowed funds	127	36	163	41	6	47
Total interest bearing liabilities	66	281	347	83	(42)	41
Net interest income (1)	\$ 2,780	\$ 1,074	\$ 3,854	\$ 8,978	\$ 1,718	\$ 10,696

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

Interest and fee income from loans increased \$6,402,000 or 14.71% in 2018 compared to 2017. Interest and fee income from loans increased \$9,483,000 or 27.85% in 2017 compared to 2016. The increase in 2018 is primarily attributable to an increase in average total loans outstanding, offset by a slight decrease in the yield on loans by one basis point. The net interest income during 2018 was positively impacted by the FLB acquisition in addition to the collection of nonaccrual loans which resulted in a recovery of interest income of approximately \$720,000. The recovery was partially offset by reversal of approximately \$222,000 in interest income on loans placed on nonaccrual status during the year. Net interest income during 2017 was positively impacted by the collection of nonaccrual loans which resulted in a recovery of interest income of approximately \$1,325,000. The recovery was partially offset by reversal of approximately \$12,000 in interest income on loans placed on nonaccrual status during the year.

Average total loans for 2018 increased \$118,785,000 to \$912,128,000 compared to \$793,343,000 for 2017 and \$646,573,000 for 2016. The yield on loans for 2018 was 5.50% compared to 5.51% and 5.29% for 2017 and 2016, respectively. The impact to interest income from the accretion of the loan marks on acquired loans was an increase of \$1,158,000 and \$1,048,000 for the years ended December 31, 2018 and 2017, respectively.

Interest income from total investments on a non tax-equivalent basis, (total investments include investment securities, Federal funds sold, interest-bearing deposits in other banks, and other securities), increased \$409,000 or 2.95% in 2018 compared to 2017. The yield on average investments decreased 18 basis points to 2.88% for the year ended December 31, 2018 from 3.06% for the year

ended December 31, 2017. Average total investments decreased \$41,820,000 to \$526,606,000 in 2018 compared to \$568,426,000 in 2017. In 2017, total investment income on a non tax-equivalent basis increased \$1,217,000 or 9.64% compared to 2016.

Our investment portfolio consists primarily of securities issued by U.S. Government sponsored entities and agencies collateralized by mortgage backed obligations and obligations of states and political subdivision securities. However, a significant portion of the investment portfolio is mortgage-backed securities (MBS) and collateralized mortgage obligations (CMOs). At December 31, 2018, we held \$361,080,000 or 77.83% of the total market value of the investment portfolio in MBS and CMOs with an average yield of 2.81%. We invest in CMOs and MBS as part of our overall strategy to increase our net interest margin. CMOs and MBS by their nature are affected by prepayments which are impacted by changes in interest rates. In a normal declining rate environment, prepayments from MBS and CMOs would be expected to increase and the expected life of the investment would be expected to shorten. Conversely, if interest rates increase, prepayments normally would be expected to decline and the average life of the MBS and CMOs would be expected to extend. Premium amortization and discount accretion of these investments affects our net interest income. Our management monitors the prepayment trends of these investments and adjusts premium amortization and discount accretion based on several factors. These factors include the type of investment, the investment structure, interest rates, interest rates on new mortgage loans, expectation of interest rate changes, current economic conditions, the level of principal remaining on the bond, the bond coupon rate, the bond origination date, and volume of available bonds in market. The calculation of premium amortization and discount accretion is by nature inexact, and represents management's best estimate of principal pay downs inherent in the total investment portfolio.

The cumulative net-of-tax effect of the change in market value of the available-for-sale investment portfolio as of December 31, 2018 was an unrealized loss of \$4,407,000 and is reflected in the Company's equity. At December 31, 2018, the effective duration of the investment portfolio was 3.54 years and the market value reflected a pre-tax unrealized loss of \$6,257,000. Management reviews market value declines on individual investment securities to determine whether they represent other-than-temporary impairment (OTTI). For the years ended December 31, 2018 and 2017, no OTTI was recorded. For the year ended December 31, 2016, OTTI was recorded in the amount of \$136,000. Future deterioration in the market values of our investment securities may require the Company to recognize additional OTTI losses.

A component of the Company's strategic plan has been to use its investment portfolio to offset, in part, its interest rate risk relating to variable rate loans. Measured at December 31, 2018, an immediate rate increase of 200 basis points would result in an estimated decrease in the market value of the investment portfolio by approximately \$33,989,000. Conversely, with an immediate rate decrease of 200 basis points, the estimated increase in the market value of the investment portfolio would be \$32,468,000. The modeling environment assumes management would take no action during an immediate shock of 200 basis points. However, the Company uses those increments to measure its interest rate risk in accordance with regulatory requirements and to measure the possible future risk in the investment portfolio. For further discussion of the Company's market risk, refer to Quantitative and Qualitative Disclosures about Market Risk.

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

Total interest income in 2018 increased \$6,811,000 to \$64,187,000 compared to \$57,376,000 in 2017 and \$46,676,000 in 2016. The increase was the result of yield changes, increase in interest rates, asset mix changes, and an increase in average earning assets. The tax-equivalent yield on interest earning assets increased to 4.54% for the year ended December 31, 2018 from 4.48% for the year ended December 31, 2017. Average interest earning assets increased to \$1,435,025,000 for the year ended December 31, 2018 compared to \$1,358,930,000 for the year ended December 31, 2017. Average interest-earning deposits in other banks decreased \$12,654,000 comparing 2018 to 2017. Average yield on these deposits was 1.91% compared to 1.16% on December 31, 2018 and December 31, 2017 respectively. Average investments and interest-earning deposits decreased \$41,820,000 but the tax equivalent yield on those assets

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INTEREST INCOME AND EXPENSE (Continued)

decreased 18 basis points. Average total loans increased \$118,785,000 and the yield on average loans decreased one basis point.

The increase in total interest income for 2017 was the result of yield changes, asset mix changes, and an increase in average earning assets. The yield on interest-earning assets increased to 4.48% for the year ended December 31, 2017 from 4.15% for the year ended December 31, 2016. Average interest-earning assets increased to \$1,358,930,000 for the year ended December 31, 2017 compared to \$1,205,142,000 for the year ended December 31, 2016.

Interest expense on deposits in 2018 increased \$184,000 or 18.99% to \$1,153,000 compared to \$969,000 in 2017 and increased as compared to \$975,000 in 2016. The yield on interest-bearing deposits increased 3 basis points to 0.15% in 2018 from 0.12% in 2017. The yield on interest-bearing deposits decreased one basis point to 0.12% in 2017 from 0.13% in 2016. Average interest-bearing deposits were \$780,449,000 for 2018 compared to \$784,318,000 and \$727,080,000 for 2017 and 2016, respectively.

Average other borrowings were \$12,180,000 with an effective rate of 2.72% for 2018 compared to \$6,930,000 with an effective rate of 2.42% for 2017. In 2016, the average other borrowings were \$5,157,000 with an effective rate of 2.35%. Included in other borrowings are the junior subordinated deferrable interest debentures acquired from Service 1st, advances on lines of credit, advances from the Federal Home Loan Bank (FHLB), and overnight borrowings. The debentures carry a floating rate based on the three month LIBOR plus a margin of 1.60%. The rate was 4.04% for 2018, 2.96% for 2017, and 2.48% for 2016.

The cost of all interest-bearing liabilities was 0.19% and 0.14% basis points for 2018 and 2017, respectively, compared to 0.15% for 2016. The cost of total deposits increased to 0.09% for the year ended December 31, 2018, compared to 0.08% and 0.09% for the years ended December 31, 2017 and 2016, respectively. Average demand deposits increased 10.66% to \$553,305,000 in 2018 compared to \$499,987,000 for 2017 and \$417,151,000 for 2016. The ratio of average non-interest demand deposits to average total deposits increased to 41.48% for 2018 compared to 38.93% and 36.46% for 2017 and 2016, respectively.

NET INTEREST INCOME BEFORE PROVISION FOR CREDIT LOSSES

Net interest income before provision for credit losses for 2018 increased \$6,464,000 or 11.49% to \$62,703,000 compared to \$56,239,000 for 2017 and \$45,580,000 for 2016. The increase in 2018 was due to the increase in average earning assets while the yield on interest bearing liabilities increased 5 basis point. Our net interest margin (NIM) increased 4 basis points. Yield on interest earning assets increased 6 basis points. The change in the mix of average interest earning assets also affected NIM. The increase in net interest margin in the period-to-period comparison resulted primarily from the increase in the effective yield on interest earning deposits in other banks and Federal Funds sold, offset by the decrease in the effective yield on average investment securities, and the decrease in the yield on the Company's loan portfolio. Net interest income before provision for credit losses increased \$10,659,000 in 2017 compared to 2016, primarily due to the increase in average earning assets. Average interest-earning assets were \$1,435,025,000 for the year ended December 31, 2018 with a NIM of 4.44% compared to \$1,358,930,000 with a NIM of 4.40% in 2017, and \$1,205,142,000 with a NIM of 4.06% in 2016. For a discussion of the repricing of our assets and liabilities, refer to Quantitative and Qualitative Disclosure about Market Risk.

PROVISION FOR CREDIT LOSSES

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

The establishment of an adequate credit allowance is based on both an accurate risk rating system and loan portfolio management tools. The Board of Directors have established initial responsibility for the accuracy of credit risk

grades with the individual credit officer. The Credit Review Officer (CRO) will review loans to ensure the accuracy of the risk grade and is empowered to change any risk grade, as appropriate. The CRO is not involved in loan originations. Quarterly, the credit officers must certify the current risk grade of the loans in their portfolio. The CRO reviews the certifications. At least quarterly the CRO reports his activities to the Board of Directors Audit Committee; and at least annually the loan portfolio is reviewed by a third party credit reviewer and by various regulatory agencies.

Quarterly, the Chief Credit Officer (CCO) sets the specific reserve for all impaired credits. Additionally, the CCO is responsible to ensure that the general reserves on non-impaired loans are properly set each quarter. This process includes the utilization of loan delinquency reports, classified asset reports, collateral analysis and portfolio concentration reports to assist in accurately assessing credit risk and establishing appropriate reserves.

The allowance for credit losses is reviewed at least quarterly by the Board of Directors Audit Committee and by the Board of Directors. General reserves are allocated to loan portfolio categories using percentages which are based on both historical risk elements such as delinquencies and losses and predictive risk elements such as economic, competitive and environmental factors. We have adopted the specific reserve approach to allocate reserves to each impaired credit for the purpose of estimating potential loss exposure. Although the allowance for credit losses is allocated to various portfolio categories, it is general in nature and available for the loan portfolio in its entirety. Changes in the allowance for credit losses may be required based on the results of independent loan portfolio examinations, regulatory agency examinations, or our own internal review process. Additions are also required when, in management's judgment, the allowance does not properly reflect the portfolio's probable loss exposure. Management believes that all adjustments, if any, to the allowance for credit losses are supported by the timely and consistent application of methodologies and processes resulting in detailed documentation of the allowance calculation and other portfolio trending analysis.

The allocation of the allowance for credit losses is set forth below (in thousands):

Loan Type	December 31, 2018	December 31, 2017
Commercial:		
Commercial and industrial	\$ 1,604	\$ 1,784
Agricultural production	67	287
Real estate:		
Owner occupied	1,131	1,252
Real estate construction and other land loans	1,271	1,004
Commercial real estate	3,017	1,958
Agricultural real estate	947	1,441
Other real estate	173	140
Consumer:		
Equity loans and lines of credit	419	464
Consumer and installment	407	361
Unallocated reserves	68	87
Total allowance for credit losses	\$ 9,104	\$ 8,778

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

Managing high-risk credits identified through the risk evaluation methodology includes developing a business strategy with the customer to mitigate our potential losses. Management continues to monitor these credits with a view to identifying as early as possible when, and to what extent, additional provisions may be necessary. Management believes that the level of allowance for loan losses allocated to commercial and real estate loans has been adjusted accordingly.

During the year ended December 31, 2018, the Company recorded a provision for credit losses of \$50,000 compared to a reverse provision of \$1,150,000 and a reverse provision of \$5,850,000 for the same periods in 2017

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PROVISION FOR CREDIT LOSSES (Continued)

and 2016, respectively. The recorded provision and reverse provisions to the allowance for credit losses are primarily the result of our assessment of the overall adequacy of the allowance for credit losses considering a number of factors as discussed in the "Allowance for Credit Losses" section.

During the years ended December 31, 2018, 2017 and 2016 the Company had net recoveries totaling \$276,000, \$602,000, and \$5,566,000, respectively. The net charge-off (recovery) ratio, which reflects net charge-offs (recoveries) to average loans, was (0.03)%, (0.08)% and (0.86)% for 2018, 2017, and 2016, respectively.

Nonperforming loans were \$2,740,000 and \$2,875,000 at December 31, 2018 and 2017, respectively. Nonperforming loans as a percentage of total loans were 0.30% at December 31, 2018 compared to 0.32% at December 31, 2017. The Company had no other real estate owned at December 31, 2018, December 31, 2017, and December 31, 2016. The carrying value of foreclosed assets was \$70,000 at December 31, 2017, and is included in other assets on the consolidated balance sheets. No foreclosed assets were recorded at December 31, 2018 or December 31, 2016. At December 31, 2018, we had \$1,208,000 loans past due, not including nonaccrual loans compared to \$1,281,000 loans past due at December 31, 2017.

Economic pressures may negatively impact the financial condition of borrowers to whom the Company has extended credit and as a result when negative economic conditions are anticipated, we may be required to make significant provisions to the allowance for credit losses. The Bank conducts banking operation principally in California's Central Valley. The Central Valley is largely dependent on agriculture. The agricultural economy in the Central Valley is therefore important to our financial performance, results of operation and cash flows. We are also dependent in a large part upon the business activity, population growth, income levels and real estate activity in this market area. A downturn in agriculture and the agricultural related businesses could have a material adverse effect on our business, results of operation and financial condition. The agricultural industry has been affected by declines in prices and the rates of price growth for various crops and other agricultural commodities. Similarly, weaker prices could reduce the cash flows generated by farms and the value of agricultural land in our local markets and thereby increase the risk of default by our borrowers or reduce the foreclosure value of agricultural land and equipment that serve as collateral of our loans. Further declines in commodity prices or collateral values may increase the incidence of default by our borrowers. Moreover, weaker prices might threaten farming operations in the Central Valley, reducing market demand for agricultural lending. In particular, farm income has seen recent declines, and in line with the downturn in farm income, farmland prices are coming under pressure.

We have been and will continue to be proactive in looking for signs of deterioration within the loan portfolio in an effort to manage credit quality and work with borrowers where possible to mitigate losses. As of December 31, 2018, there were \$28.4 million in classified loans of which \$19.2 million related to agricultural real estate, \$2.6 million to commercial and industrial loans, \$0.9 million to real estate owner occupied, \$3.0 million to real estate construction, and \$1.1 million to commercial real estate. This compares to \$50.0 million in classified loans as of December 31, 2017 of which \$26.5 million related to agricultural real estate, \$3.9 million to real estate construction, \$7.9 million to commercial and industrial, \$3.9 million to agricultural production, and \$3.4 million to commercial real estate.

As of December 31, 2018, we believe, based on all current and available information, the allowance for credit losses is adequate to absorb probable incurred losses within the loan portfolio; however, no assurance can be given that we may not sustain charge-offs which are in excess of the allowance in any given period. Refer to "Allowance for Credit Losses" below for further information.

NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES

Net interest income, after the provision for credit losses was \$62,653,000 for 2018 compared to \$57,389,000 and \$51,430,000 for 2017 and 2016, respectively.

NON-INTEREST INCOME

Non-interest income is comprised of customer service charges, gains on sales and calls of investment securities, income from appreciation in cash surrender value of bank owned life insurance, loan placement fees, Federal Home Loan Bank dividends, and other income. Non-interest income was \$10,324,000 in 2018 compared to \$10,836,000 and \$9,591,000 in 2017 and 2016, respectively. The \$512,000 or 4.72% decrease in non-interest income in 2018 resulted primarily from decreases in net realized gains on sales and calls of investment securities and service charge income, partially offset by a increase in loan placement fees, net gain on the sale of the Company's credit card portfolio, interchange fees, appreciation in cash surrender value of bank owned life insurance, and Federal Home Loan Bank dividends compared to 2017. The \$1,245,00 or 12.98% increases in non-interest income in 2017 compared to 2016 was due to increases in net realized gains on sales and calls of investment securities, service charge income, interchange fees, and other income, partially offset by a decrease in Federal Home Loan Bank dividends, and loan placement fees.

Customer service charges decreased \$67,000 to \$2,986,000 in 2018 compared to \$3,053,000 in 2017 and \$2,849,000 in 2016. The increase in 2017 from 2016 resulted from increase in our customer base from the SVB and FLB acquisitions.

During the year ended December 31, 2018, we realized net gains on sales and calls of investment securities of \$1,314,000, compared to \$2,802,000 in 2017 and \$1,920,000 in 2016. In 2016, we recorded an other-than-temporary impairment loss of \$136,000 as compared to none during the years ended December 31, 2018, and 2017. The net gains in 2018, 2017, and 2016 were the results of partial restructuring of the investment portfolio designed to improve the future performance of the portfolio. See Note 4 to the audited Consolidated Financial Statements for more detail.

Income from the appreciation in cash surrender value of bank owned life insurance (BOLI) totaled \$695,000 in 2018 compared to \$621,000 and \$558,000 in 2017 and 2016, respectively. The Bank's salary continuation and deferred compensation plans and the related BOLI are used as retention tools for directors and key executives of the Bank.

Interchange fees totaled \$1,462,000 in 2018 compared to \$1,458,000 and \$1,228,000 in 2017 and 2016, respectively. Part of the increases in 2018 and 2017 was attributable to the FLB and SVB acquisitions.

We earn loan placement fees from the brokerage of single-family residential mortgage loans provided for the convenience of our customers. Loan placement fees increased \$2,000 in 2018 to \$708,000 compared to \$706,000 in 2017 and \$1,083,000 in 2016.

The Bank holds stock from the Federal Home Loan Bank in relationship with its borrowing capacity and generally receives quarterly dividends. As of December 31, 2018 and 2017, we held \$6,843,000 in FHLB stock. Dividends in 2018 increased to \$590,000 compared to \$443,000 in 2017 and \$630,000 in 2016.

A net gain of \$462,000 on the sale of the Company's credit card portfolio was recorded during the year ended December 31, 2018. Other income increased to \$2,107,000 in 2018 compared to \$1,753,000 and \$1,459,000 in 2017 and 2016, respectively.

NON-INTEREST EXPENSES

Salaries and employee benefits, occupancy and equipment, regulatory assessments, acquisition and integration-related expenses, data processing expenses, ATM/Debit card expenses, license and maintenance contract expenses, information technology, and professional services (consisting of audit, accounting, consulting and legal fees) are the major categories of non-interest expenses. Non-interest expenses increased \$662,000 or 1.49% to \$45,068,000 in 2018 compared to \$44,406,000 in 2017, and \$38,922,000 in 2016. The net increase period-over-period is primarily due to the FLB and SVB acquisitions. Various items are discussed below.

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NON-INTEREST EXPENSES (Continued)

Our efficiency ratio, measured as the percentage of non-interest expenses (exclusive of amortization of core deposit intangibles, other real estate owned, and repossessed asset expenses) to net interest income before provision for credit losses plus non-interest income (exclusive of realized gains or losses on sale and calls of investments) was 61.23% for 2018 compared to 62.03% for 2017 and 64.72% for 2016. The improvement in the efficiency ratio in 2018 and 2017 is due to the growth in revenues outpacing the growth in non-interest expense.

Salaries and employee benefits increased \$1,483,000 or 5.99% to \$26,221,000 in 2018 compared to \$24,738,000 in 2017 and \$21,881,000 in 2016. Full time equivalents were 316 for the year ended December 31, 2018 compared to 334 for the year ended December 31, 2017. The increase in salaries and employee benefits in 2018 compared to 2017 is a result of higher overall salary and benefit expenses.

For the years ended December 31, 2018, 2017, and 2016, the compensation cost recognized for share based compensation was \$482,000, \$384,000 and \$284,000, respectively. As of December 31, 2018, there was \$677,000 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under all plans. The cost is expected to be recognized over a weighted average period of 2.04 years. See *Notes 1 and 14* to the audited Consolidated Financial Statements for more detail. No options to purchase shares of the Company's common stock were issued during the years ending December 31, 2018 and 2017. Restricted common stock awards of 22,204 shares were awarded in 2018. No restricted stock shares were awarded in 2017.

Occupancy and equipment expense increased \$786,000 or 15.16% to \$5,972,000 in 2018 compared to \$5,186,000 in 2017 and \$4,754,000 in 2016. The net increase year over year was primarily attributable to the FLB acquisition and consolidation of three branches in addition to increased contract repairs throughout the entire Company. The addition of five new branches from the FLB and SVB acquisitions resulted in an approximately \$338,000 increase in rent expense in 2017 as compared to 2016. The Company made no changes in its depreciation expense methodology.

Regulatory assessments were \$619,000 in 2018 compared to \$652,000 and \$642,000 in 2017 and 2016, respectively. The assessment base for calculating the amount owed is average assets minus average tangible equity. Beginning in the third quarter of 2016, the FDIC approved a final rule revising DIF assessment formulas which resulted in lower assessments for the Company. 2017 and 2016 were higher as compared to 2018 due to the additional assessments on the acquired institutions.

Data processing expenses were \$1,666,000 in 2018 compared to \$1,740,000 in 2017 and \$1,707,000 in 2016. The \$74,000 or 4.25% decrease in 2018 is from the consolidation of processes after the conversion of the acquired institutions was completed in 2018. Acquisition and integration expenses related to the FLB and SVB mergers were \$217,000 in 2018 compared to \$1,828,000 in 2017 and \$1,782,000 in 2016. Professional services decreased \$34,000 in 2018 compared to 2017.

Amortization of core deposit intangibles was \$455,000 for 2018, \$234,000 for 2017, and \$149,000 for 2016. During 2018, amortization expense related to FLB core deposit intangible (CDI) was \$247,000, amortization expense related to SVB core deposit intangible (CDI) was \$72,000, and amortization expense related to VCB CDI was \$136,000. During 2017, amortization expense related to FLB CDI was \$47,000, SVB CDI was \$50,000 and amortization expense related to VCB CDI was \$137,000. During 2016, amortization expense related to SVB CDI was \$12,000, and amortization expense related to VCB CDI was \$137,000.

ATM/Debit card expenses decreased \$11,000 to \$739,000 for the year ended December 31, 2018 compared to \$750,000 in 2017 and \$633,000 in 2016. Information technology expenses increased \$295,000 to \$1,113,000 for the year ended December 31, 2018 compared to \$818,000 and \$531,000 in 2017 and 2016, respectively. Other non-interest expenses decreased \$375,000 or 7.48% to \$4,636,000 in 2018 compared to \$5,011,000 in 2017 and \$3,801,000 in 2016.

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

	For the years ended December 31,					
	Other Expense 2018	% Average Assets	Other Expense 2017	% Average Assets	Other Expense 2016	% Average Assets
	(Dollars in thousands)					
Stationery/supplies	\$ 281	0.02%	\$ 292	0.02%	\$ 247	0.02%
Amortization of software	303	0.02%	289	0.02%	257	0.02%
Telephone	217	0.01%	265	0.02%	357	0.03%
Alarm	101	0.01%	130	0.01%	103	0.01%
Postage	209	0.01%	205	0.01%	200	0.02%
Armored courier fees	274	0.02%	266	0.02%	227	0.02%
Risk management expense	195	0.01%	207	0.01%	150	0.01%
Loss on sale or write-down of assets	2	-%	187	0.01%	4	-%
Donations	243	0.02%	249	0.02%	171	0.01%
Personnel other	167	0.01%	259	0.02%	161	0.01%
Credit card expense	121	0.01%	245	0.02%	196	0.01%
Education/training	172	0.01%	174	0.01%	154	0.01%
Loan related expenses	77	-%	132	0.01%	35	-%
General insurance	165	0.01%	159	0.01%	159	0.01%
Travel and mileage Expense	267	0.02%	211	0.01%	146	0.01%
Operating losses	452	0.03%	150	0.01%	175	0.01%
Shareholder services	129	0.01%	102	0.01%	83	0.01%
Other	1,261	0.08%	1,489	0.10%	976	0.07%
Total other non-interest expense	\$ 4,636	0.29%	\$ 5,011	0.34%	\$ 3,801	0.29%

PROVISION FOR INCOME TAXES

Our effective income tax rate was 23.7% for 2018 compared to 41.1% for 2017 and 31.3% for 2016. The Company reported an income tax provision of \$6,620,000, \$9,793,000, and \$6,917,000 for the years ended December 31, 2018, 2017, and 2016, respectively. With the Tax Cuts and Jobs Act (the "Act") enacted on December 22, 2017, the Company's federal income tax rate changed from 35% to 21% effective as of the beginning of 2018. The decrease in the effective tax rate was the result of the change in the federal rate offset by a sizable decrease in tax exempt interest. As a result of the enactment of the Act the federal tax rate applied to the Company's deferred taxes was adjusted as of December 31, 2017 to reflect the 2018 tax rates (the rates at which the deferred tax items are expected to reverse). The change to the tax rates (including the rate change applied to deferred taxes reflected in other comprehensive income and certain tax-advantaged investments as reflected in other assets) resulted in an increase to the Company's tax provision of \$3,535,000 in 2017. As part of the Act for tax years beginning after December 31, 2017, alternative minimum tax credit carryforwards are refundable and are expected to be fully refunded by 2022. As such, they are not dependent on future taxable income to be realized and have been classified as an other receivable. The effective tax rate in 2016 was affected by the large negative provision for credit losses which resulted in higher pretax and taxable income and also diluted the impact of the Company's tax exempt municipal bonds and other tax planning strategies.

Some items of income and expense are recognized in different years for tax purposes than when applying generally accepted accounting principles leading to timing differences between the Company's actual tax liability, and the amount accrued for this liability based on book income. These temporary differences comprise the "deferred" portion of the Company's tax expense or benefit, which is accumulated on the Company's books as a deferred tax asset or deferred tax liability until such time as they reverse.

Realization of the Company's deferred tax assets is primarily dependent upon the Company generating sufficient future taxable income to obtain benefit from the reversal of net deductible temporary differences and the utilization of tax credit carryforwards and the net operating loss carryforwards for Federal and California state income tax purposes. The amount of deferred tax assets considered realizable is subject to adjustment in future periods based on estimates of future taxable income. Under generally accepted accounting principles a valuation allowance is required to be recognized if it is "more likely than not" that the deferred tax assets will not be realized. The determination of the realization of the deferred tax assets is highly subjective and dependent upon

Management's Discussion and Analysis

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PROVISION FOR INCOME TAXES (Continued)

judgment concerning management's evaluation of both positive and negative evidence, including forecasts of future income, cumulative losses, applicable tax planning strategies, and assessments of current and future economic and business conditions.

The Company had the net deferred tax assets of \$11.183 million and \$8.024 million at December 31, 2018 and 2017, respectively. After consideration of the matters in the preceding paragraph, the Company determined that it is more likely than not that the net deferred tax assets at December 31, 2018 and 2017 will be fully realized in future years.

FINANCIAL CONDITION

SUMMARY OF CHANGES IN CONSOLIDATED BALANCE SHEETS

Total assets were \$1,537,836,000 as of December 31, 2018, compared to \$1,661,655,000 as of December 31, 2017, a decrease of 7.45% or \$123,819,000. Total gross loans were \$918,695,000 as of December 31, 2018, compared to \$900,679,000 as of December 31, 2017, an increase of \$18,016,000 or 2.00%. The total investment portfolio (including Federal funds sold and interest-earning deposits in other banks) decreased 20.98% or \$126,869,000 to \$477,932,000. Total deposits decreased 10.06% or \$143,389,000 to \$1,282,298,000 as of December 31, 2018, compared to \$1,425,687,000 as of December 31, 2017. Shareholders' equity increased \$10,179,000 or 4.86% to \$219,738,000 as of December 31, 2018, compared to \$209,559,000 as of December 31, 2017. The increase in shareholders' equity was driven by the retention of earnings, net of dividends paid, offset by a decrease in net unrealized gains on available-for-sale (AFS) securities recorded, net of estimated taxes, in accumulated other comprehensive income (AOCI). Accrued interest payable and other liabilities were \$20,645,000 as of December 31, 2018, compared to \$21,254,000 as of December 31, 2017, a decrease of \$609,000.

FAIR VALUE

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

See Note 3 of the Notes to Consolidated Financial Statements for additional information about the level of pricing transparency associated with financial instruments carried at fair value.

INVESTMENTS

The following table reflects the balances for each category of securities at year end:

	Amortized Cost at December 31,		
	2018	2017	2016
Available-for-Sale Securities (In thousands)			
U.S. Government agencies	\$ 21,723	\$ 65,994	\$ 69,005
Obligations of states and political subdivisions	79,886	136,955	288,543
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	239,388	237,210	181,785
Private label mortgage and asset backed securities	129,165	91,033	1,807
Total Available-for-Sale Securities	\$ 470,162	\$ 531,192	\$ 541,140

Our investment portfolio consists primarily of U.S. Government sponsored entities and agencies collateralized by mortgage backed obligations and obligations of states and political subdivision securities and are classified at the date of acquisition as available-for-sale or held-to-maturity. As of December 31, 2018, investment securities with a fair value of \$79,662,000, or 17.17% of our investment securities portfolio, were held as collateral for public funds, short and long-term borrowings, treasury, tax, and for other purposes. Our investment policies are established by the Board of Directors and implemented by our Investment/Asset Liability Committee. They are designed primarily to provide and maintain liquidity, to enable us to meet our pledging requirements for public money and borrowing arrangements, to generate a favorable return on investments without incurring undue interest rate and credit risk, and to complement our lending activities.

Our investment portfolio as a percentage of total assets is generally higher than our peers due primarily to our comparatively low loan-to-deposit ratio. Our loan-to-deposit ratio at December 31, 2018 was 71.64% compared to 63.18% at December 31, 2017. The loan to deposit ratio of our peers was 82.00% at December 31, 2018. Peer group information from S&P Global Market Intelligence data includes bank holding companies in central California with assets from \$600 million to \$3.5 billion. The total investment portfolio, including Federal funds sold and interest-earning deposits in other banks, decreased 20.98% or \$126,869,000 to \$477,932,000 at December 31, 2018, from \$604,801,000 at December 31, 2017. The market value of the portfolio reflected an unrealized loss of \$6,257,000 at December 31, 2018, compared to an unrealized gain of \$4,089,000 at December 31, 2017.

Losses recognized in 2018, 2017, and 2016 were incurred in order to reposition the investment securities portfolio based on the current rate environment. The securities which were sold at a loss were acquired when the rate environment was not as volatile. The securities which were sold were primarily purchased strategically several years ago in view of the rate environment at that time. The Company is addressing risks in the security portfolio by selling these securities and using proceeds to purchase securities that meet the Company's current risk profile.

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

As of December 31, 2018, the Company performed an analysis of the investment portfolio to determine whether any of the investments held in the portfolio had an other-than-temporary impairment (OTTI). Management evaluated all investment securities with an unrealized loss at December 31, 2018, and identified those that had an unrealized loss for at least a consecutive 12 month period, which had an unrealized loss at December 31, 2018 greater than 10% of the recorded book value on that date, or which had an unrealized loss of more than \$10,000. Management also analyzed any securities that may have been downgraded by credit rating agencies.

For those securities that met the evaluation criteria, management obtained and reviewed the most recently published national credit ratings for those securities. For those securities that were obligations of states and political subdivisions with an investment grade rating by the rating agencies, management also evaluated the financial condition of the municipality and any applicable municipal bond insurance provider and concluded during March 2016 that a \$136,000 credit related impairment related to one security with a fair value of \$2,995,000 and a pre-impairment amortized cost of \$3,131,000 existed. The Company recorded an other-than-temporary impairment loss of \$136,000 during the twelve months ended December 31, 2016. There were no OTTI losses recorded during the twelve months ended December 31, 2018 or December 31, 2017.

At December 31, 2018, the Company had a total of 36 private label mortgage backed securities (PLMBS) with a remaining principal balance of \$129,165,000 and a net unrealized loss of approximately \$3,016,000. Eight of these PLMBS with a remaining principal balance of \$1,137,000 had credit ratings below investment grade. The Company continues to monitor these securities for changes in credit ratings or other indications of credit deterioration. No credit related OTTI charges related to PLMBS were recorded during the years ended December 31, 2018 or December 31, 2017.

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INVESTMENTS (Continued)

The amortized cost, maturities and weighted average yield of investment securities at December 31, 2018 are summarized in the following table.

(Dollars in thousands)	In one year or less		After one through five years		After five through ten years		After ten years		Total	
	Amount	Yield(1)	Amount	Yield(1)	Amount	Yield(1)	Amount	Yield(1)	Amount	Yield(1)
Available-for-Sale Securities										
Debt securities(1)										
U.S. Government agencies	\$ -	-	\$ -	-	\$ 5,591	6.16%	\$ 16,132	5.48%	\$ 21,723	5.65%
Obligations of states and political subdivisions (2)	-	-	2,769	2.13%	21,831	4.24%	55,286	4.56%	79,886	4.39%
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	-	-	136	5.90%	266	5.18%	238,987	3.93%	239,389	3.94%
Private label residential mortgage and asset backed securities	47	4.75%	-	-	15	7.22%	129,102	3.74%	129,164	3.74%
	<u>\$ 47</u>	<u>4.75%</u>	<u>\$ 2,905</u>	<u>2.31%</u>	<u>\$27,703</u>	<u>4.63%</u>	<u>\$439,507</u>	<u>4.15%</u>	<u>\$470,162</u>	<u>4.04%</u>

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

(2) Not computed on a tax equivalent basis.

LOANS

Total gross loans increased \$18,016,000 or 2.00% to \$918,695,000 as of December 31, 2018, compared to \$900,679,000 as of December 31, 2017. The following table sets forth information concerning the composition of our loan portfolio as of December 31, 2018, 2017, 2016, 2015, and 2014.

Loan Type (Dollars in thousands)	2018		2017		2016		2015		2014	
	Amount	% of Total Loans								
Commercial:										
Commercial and industrial	\$ 101,533	11.1%	\$ 100,856	11.2%	\$ 88,652	11.7%	\$ 102,197	17.1%	\$ 89,007	15.5%
Agricultural production	7,998	0.9%	14,956	1.7%	25,509	3.4%	30,472	5.1%	39,140	6.8%
Total commercial	109,531	12.0%	115,812	12.9%	114,161	15.1%	132,669	22.2%	128,147	22.3%
Real estate:										
Owner occupied	183,169	19.9%	204,452	22.7%	191,665	25.3%	168,910	28.2%	176,804	30.9%
Real estate-construction and other land loans	101,606	11.1%	96,460	10.7%	69,200	9.1%	38,685	6.5%	38,923	6.8%
Commercial real estate	305,118	33.2%	269,254	29.9%	184,225	24.3%	117,244	19.6%	106,788	18.7%
Agricultural real estate	76,884	8.4%	76,081	8.4%	86,761	11.5%	74,867	12.5%	57,501	10.0%
Other real estate	32,799	3.6%	31,220	3.5%	18,945	2.7%	10,520	1.8%	6,611	1.2%
Total real estate	699,576	76.2%	677,467	75.2%	550,796	72.9%	410,226	68.6%	386,627	67.6%
Consumer:										
Equity loans and lines of credit	69,958	7.6%	76,404	8.5%	64,494	8.5%	42,296	7.1%	47,575	8.3%
Consumer and installment	38,038	4.2%	29,637	3.4%	25,910	3.5%	12,503	2.1%	10,093	1.8%
Total consumer	107,996	11.8%	106,041	11.9%	90,404	12.0%	54,799	9.2%	57,668	10.1%
Deferred loan fees, net	1,592		1,359		1,267		417		146	
Total gross loans (1)	918,695	100.0%	900,679	100.0%	756,628	100.0%	598,111	100.0%	572,588	100.0%
Allowance for credit losses	(9,104)		(8,778)		(9,326)		(9,610)		(8,308)	
Total loans (1)	<u>\$ 909,591</u>		<u>\$ 891,901</u>		<u>\$ 747,302</u>		<u>\$ 588,501</u>		<u>\$ 564,280</u>	
(1) Includes nonaccrual loans of:	<u>\$ 2,740</u>		<u>\$ 2,875</u>		<u>\$ 2,180</u>		<u>\$ 2,413</u>		<u>\$ 14,052</u>	

Management's Discussion and Analysis

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LOANS (Continued)

At December 31, 2018, loans acquired in the FLB, SVB and VCB acquisitions had a balance of \$189,719,000, of which \$5,875,000 were commercial loans, \$158,025,000 were real estate loans, and \$25,819,000 were consumer loans, and at December 31, 2017, the acquired loans acquired had a balance of \$243,712,000, of which \$12,554,000 were commercial loans, \$197,004,000 were real estate loans, and \$34,154,000 were consumer loans.

At December 31, 2018, in management's judgment, a concentration of loans existed in commercial loans and real-estate-related loans, representing approximately 95.8% of total loans of which 12% were commercial and 83.8% were real-estate-related. This level of concentration is consistent with 96.6% at December 31, 2017. Although we believe the loans within this concentration have no more than the normal risk of collectability, a substantial decline in the performance of the economy in general or a decline in real estate values in our

primary market areas, in particular, could have an adverse impact on collectability, increase the level of real estate-related nonperforming loans, or have other adverse effects which alone or in the aggregate could have a material adverse effect on our business, financial condition, results of operations and cash flows. The Company was not involved in any sub-prime mortgage lending activities during the years ended December 31, 2018 and 2017.

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

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

LOAN MATURITIES

The following table presents information concerning loan maturities and sensitivity to changes in interest rates of the indicated categories of our loan portfolio, as well as loans in those categories maturing after one year that have fixed or floating interest rates at December 31, 2018.

(In thousands) (net of deferred costs)

Loan Maturities:

	One Year or Less	After One Through Five Years	After Five Years	Total
Commercial and agricultural	\$ 58,040	\$ 25,372	\$ 26,119	\$ 109,531
Real estate construction and other land loans	89,665	9,687	3,130	102,482
Other real estate	29,220	117,222	450,652	597,094
Consumer and installment	9,730	13,724	84,542	107,996
	<u>\$ 186,655</u>	<u>\$ 166,005</u>	<u>\$ 564,443</u>	<u>\$ 917,103</u>

Sensitivity to Changes in Interest Rates:

Loans with fixed interest rates	\$ 78,693	\$ 93,650	\$ 80,447	\$ 252,790
Loans with floating interest rates (1)	107,962	72,355	483,996	664,313
	<u>\$ 186,655</u>	<u>\$ 166,005</u>	<u>\$ 564,443</u>	<u>\$ 917,103</u>
	<u>\$ 3,424</u>	<u>\$ 12,659</u>	<u>\$ 357,319</u>	<u>\$ 373,402</u>

(1) Includes floating rate loans which are currently at their floor rate in accordance with their respective loan agreement

NONPERFORMING ASSETS

Nonperforming assets consist of nonperforming loans, other real estate owned (OREO), and repossessed assets. Nonperforming loans are those loans which have (i) been placed on nonaccrual status; (ii) been classified as doubtful under our asset classification system; or (iii) become contractually past due 90 days or more with respect to principal or interest and have not been restructured or otherwise placed on nonaccrual status. A loan is classified as nonaccrual when 1) it is maintained on a cash basis because of deterioration in the financial condition of the borrower; 2) payment in full of principal or interest under the original contractual terms is not expected; or 3) principal or interest has been in default for a period of 90 days or more unless the loan is both well secured and in the process of collection. We measure all loans placed on nonaccrual status for impairment based on the fair value of the underlying collateral or the net present value of the expected cash flows.

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

Loans are placed on nonaccrual status and any accrued but unpaid interest income is reversed and charged against income when the payment of interest or principal is 90 days or more past due. Loans in the nonaccrual category are treated as nonaccrual loans even though we may ultimately recover all or a portion of the interest due. These loans return to accrual status when the loan becomes contractually current, future collectability of amounts due is reasonably assured, and a minimum of six months of satisfactory principal repayment

performance has occurred. See *Note 5* of the Company's audited Consolidated Financial Statements in *Item 8* of this Annual Report.

At December 31, 2018, total nonperforming assets totaled \$2,740,000, or 0.18% of total assets, compared to \$2,945,000, or 0.18% of total assets at December 31, 2017. Nonperforming assets totaled 0.30% of gross loans as of December 31, 2018 and 0.33% of gross loans as of December 31, 2017. Total nonperforming assets at December 31, 2018, included nonaccrual loans totaling \$2,740,000, no OREO, and no repossessed assets. Nonperforming assets at December 31, 2017 consisted of \$2,875,000 in nonaccrual loans, no OREO, and \$70,000 in repossessed assets. At December 31, 2018, we had one loan considered a troubled debt restructuring ("TDR") totaling \$50,000 which is included in nonaccrual loans compared to one TDR totaling \$59,000 at December 31, 2017. We have no outstanding commitments to lend additional funds to any of these borrowers. See *Note 5* of the Company's audited Consolidated Financial Statements in *Item 8* of this Annual Report concerning our recorded investment in loans for which impairment has been recognized.

A summary of nonaccrual, restructured, and past due loans at December 31, 2018, 2017, 2016, 2015, and 2014 is set forth below. The Company had no loans past due more than 90 days and still accruing interest at December 31, 2018 and 2017. Management is not aware of any potential problem loans, which were current and accruing at December 31, 2018, where serious doubt exists as to the ability of the borrower to comply with the present repayment terms. Management can give no assurance that nonaccrual and other nonperforming loans will not increase in the future.

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NONPERFORMING ASSETS (Continued)

Composition of Nonaccrual, Past Due and Restructured Loans

(As of December 31, Dollars in thousands)	2018	2017	2016	2015	2014
Nonaccrual Loans:					
Commercial and industrial	\$ 298	\$ 356	\$ 447	\$ -	\$ 7,265
Owner occupied real estate	215	-	87	324	1,363
Real estate construction and other land loans	1,439	1,397	-	-	-
Agricultural real estate	-	-	-	-	360
Commercial real estate	418	976	1,082	567	1,468
Equity loans and line of credit	320	87	526	172	1,751
Consumer and installment	-	-	18	13	19
Restructured loans (non-accruing):					
Commercial and industrial	-	-	-	29	-
Owner occupied	-	-	20	23	-
Real estate construction and other land loans	-	-	-	-	547
Equity loans and line of credit	50	59	-	1,285	1,279
Total nonaccrual	2,740	2,875	2,180	2,413	14,052
Accruing loans past due 90 days or more	-	-	-	-	-
Total nonperforming loans	<u>\$ 2,740</u>	<u>\$ 2,875</u>	<u>\$ 2,180</u>	<u>\$ 2,413</u>	<u>\$ 14,052</u>
Interest foregone	<u>\$ 267</u>	<u>\$ 210</u>	<u>\$ 245</u>	<u>\$ 340</u>	<u>\$ 716</u>
Nonperforming loans to total loans	<u>0.30%</u>	<u>0.32%</u>	<u>0.29%</u>	<u>0.40%</u>	<u>2.45%</u>
Accruing loans past due 90 days or more	<u>\$ -</u>				
Accruing troubled debt restructurings	<u>\$ 3,170</u>	<u>\$ 3,491</u>	<u>\$ 3,089</u>	<u>\$ 4,774</u>	<u>\$ 4,774</u>
Ratio of nonperforming loans to allowance for credit losses	<u>30.10%</u>	<u>32.75%</u>	<u>23.38%</u>	<u>25.11%</u>	<u>169.14%</u>
Loans considered to be impaired	<u>\$ 5,909</u>	<u>\$ 6,366</u>	<u>\$ 5,269</u>	<u>\$ 6,699</u>	<u>\$ 18,826</u>
Related allowance for credit losses on impaired loans	<u>\$ 90</u>	<u>\$ 36</u>	<u>\$ 307</u>	<u>\$ 164</u>	<u>\$ 612</u>

As of December 31, 2018 and 2017, we had impaired loans totaling \$5,909,000 and \$6,366,000, respectively. We measure our impaired loans by using the fair value of the collateral if the loan is collateral dependent and the present value of the expected future cash flows discounted at the loan's original contractual interest rate if the loan is not collateral dependent. Impaired loans are identified from internal credit review reports, past due reports, overdraft listings, and third party reports of examination. Borrowers experiencing problems such as operating losses, marginal working capital, inadequate cash flow or business interruptions which jeopardize collection of the loan are also reviewed for possible impairment classification. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Loans determined to be impaired are individually evaluated for impairment. When a loan is impaired, the Company measures impairment based

on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, it may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. For collateral dependent loans secured by real estate, we obtain external appraisals which are updated at least annually to determine the fair value of the collateral, and we record an immediate charge off for the difference between the book value of the loan and the appraised value less selling costs of the collateral. We perform quarterly internal reviews on substandard loans.

We place loans on nonaccrual status and classify them as impaired when it becomes probable that we will not receive interest and principal under the original contractual terms, or when loans are delinquent 90 days or more, unless the loan is both well secured and in the process of collection. Management maintains certain loans that have been brought current by the borrower (less than 30 days delinquent) on nonaccrual status until such time as management has determined that the loans are likely to remain current in future periods. Foregone interest on nonaccrual loans totaled \$267,000 for the year ended December 31, 2018 of which \$4,000 was attributable to troubled debt restructurings. Foregone interest on nonaccrual loans totaled \$210,000 and \$245,000 for the years ended December 31, 2017 and 2016, respectively of which \$17,000 and \$2,000 was attributable to troubled debt restructurings, respectively.

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NONPERFORMING ASSETS (Continued)

The following table provides a reconciliation of the change in non-accrual loans for the year ended December 31, 2018.

(In thousands)	Balances December 31, 2017	Additions to Nonaccrual Loans	Net Pay Downs	Transfer to Foreclosed Collateral	Returns to Accrual Status	Charge Offs	Balances December 31, 2018
Non-accrual loans:							
Commercial and industrial	\$ 356	\$ 40	\$ (98)	\$ -	\$ -	\$ -	\$ 298
Real estate	976	1,379	(1,252)	-	(470)	-	633
Real estate construction and other land loans	1,397	42	-	-	-	-	1,439
Equity loans and lines of credit	87	283	(42)	-	(8)	-	320
Consumer	-	12	-	-	-	(12)	-
Restructured loans (non-accruing):							
Equity loans and lines of credit	59	-	(9)	-	-	-	50
Total non-accrual	<u>\$ 2,875</u>	<u>\$ 1,756</u>	<u>\$ (1,401)</u>	<u>\$ -</u>	<u>\$ (478)</u>	<u>\$ (12)</u>	<u>\$ 2,740</u>

OREO represents real property taken either through foreclosure or through a deed in lieu thereof from the borrower. OREO is carried at the lesser of cost or fair market value less selling costs. As of December 31, 2018 and December 31, 2017, the Bank had no OREO properties. The Company held no repossessed assets at December 31, 2018 compared to \$70,000 at December 31, 2017, which is included in other assets on the consolidated balance sheets.

As of December 31, 2016 the Bank had no OREO properties. The carrying value of foreclosed assets was \$362,000 at December 31, 2016.

ALLOWANCE FOR CREDIT LOSSES

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

For all portfolio segments, the determination of the general reserve for loans that are not impaired is based on estimates made by management including, but not limited to, consideration of historical losses by portfolio segment (and in certain cases peer loss data) over the most recent 20 quarters, and qualitative factors including economic trends in the Company's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the loan portfolio, and probable losses incurred in the portfolio taken as a whole. Management has determined that the most recent 20 quarters was an appropriate look-back period based on several factors including the current global economic uncertainty and various national and local economic indicators, and a time period sufficient to capture enough data due to the size of the portfolio to produce statistically accurate historical loss calculations. We believe this period is an appropriate look-back period.

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

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

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

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

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ALLOWANCE FOR CREDIT LOSSES (Continued)

The following table summarizes the Company's loan loss experience, as well as provisions and recoveries (charge-offs) to the allowance and certain pertinent ratios for the periods indicated:

(Dollars in thousands)	2018	2017	2016	2015	2014
Loans outstanding at December 31,	<u>\$ 917,103</u>	<u>\$ 899,320</u>	<u>\$ 755,361</u>	<u>\$ 597,694</u>	<u>\$ 572,442</u>
Average loans outstanding during the year	<u>\$ 912,128</u>	<u>\$ 793,343</u>	<u>\$ 646,573</u>	<u>\$ 586,762</u>	<u>\$ 539,529</u>
Allowance for credit losses:					
Balance at beginning of year	\$ 8,778	\$ 9,326	\$ 9,610	\$ 8,308	\$ 9,208
Deduct loans charged off:					
Commercial and industrial	(94)	(197)	(621)	(802)	(7,423)
Agricultural production	-	(10)	-	-	(1,722)
Owner occupied	-	(22)	-	-	(183)
Commercial real estate	-	-	-	-	-
Consumer loans	(116)	(235)	(262)	(159)	(506)
Total loans charged off	<u>(210)</u>	<u>(464)</u>	<u>(883)</u>	<u>(961)</u>	<u>(9,834)</u>
Add recoveries of loans previously charged off:					
Commercial and industrial	207	850	3,656	954	171
Agricultural production	-	10	1,631	90	-
Owner occupied	21	49	-	-	150
Real estate construction and other land loans	-	-	702	32	364
Commercial real estate	81	17	283	-	-
Consumer loans	177	140	177	587	264
Total recoveries	<u>486</u>	<u>1,066</u>	<u>6,449</u>	<u>1,663</u>	<u>949</u>
Net recoveries (charge offs)	<u>276</u>	<u>602</u>	<u>5,566</u>	<u>702</u>	<u>(8,885)</u>
(Reversal) Provision charged to credit losses	<u>50</u>	<u>(1,150)</u>	<u>(5,850)</u>	<u>600</u>	<u>7,985</u>
Balance at end of year	<u>\$ 9,104</u>	<u>\$ 8,778</u>	<u>\$ 9,326</u>	<u>\$ 9,610</u>	<u>\$ 8,308</u>
Allowance for credit losses as a percentage of outstanding loan balance	<u>0.99%</u>	<u>0.98%</u>	<u>1.23%</u>	<u>1.61%</u>	<u>1.45%</u>
Net recoveries (charge offs) to average loans outstanding	<u>0.03%</u>	<u>0.08%</u>	<u>0.86%</u>	<u>0.12%</u>	<u>(1.65%)</u>

Managing credits identified through the risk evaluation methodology includes developing a business strategy with the customer to mitigate our losses. Our management continues to monitor these credits with a view to identifying as early as possible when, and to what extent, additional provisions may be necessary.

The allowance for credit losses is reviewed at least quarterly by the Bank's and our Board of Directors' Audit/Compliance Committee. Reserves are allocated to loan portfolio segments using percentages which are based on both historical risk elements such as delinquencies and losses and predictive risk elements such as

economic, competitive and environmental factors. We have adopted the specific reserve approach to allocate reserves to each impaired asset for the purpose of estimating potential loss exposure. Although the allowance for credit losses is allocated to various portfolio categories, it is general in nature and available for the loan portfolio in its entirety. Additions may be required based on the results of independent loan portfolio examinations, regulatory agency examinations, or our own internal review process. Additions are also required when, in management's judgment, the reserve does not properly reflect the potential loss exposure.

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ALLOWANCE FOR CREDIT LOSSES (Continued)

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

Loan Type (Dollars in thousands)	2018		2017		2016		2015		2014	
	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans
Commercial:										
Commercial and industrial	\$ 1,604	11.1%	\$ 1,784	11.2%	\$ 1,884	11.7%	\$ 3,143	17.1%	\$ 2,753	15.5%
Agricultural production	67	0.9%	287	1.7%	296	3.4%	419	5.1%	377	6.8%
Real estate:										
Owner occupied	1,131	19.9%	1,252	22.7%	1,408	25.3%	1,556	28.2%	1,380	30.9%
Real estate construction and other land loans	1,271	11.1%	1,004	10.7%	698	9.1%	694	6.5%	837	6.8%
Commercial real estate	3,017	33.2%	1,958	29.9%	1,969	24.3%	1,686	19.6%	1,201	18.7%
Agricultural real estate	947	8.4%	1,441	8.4%	1,969	11.5%	1,149	12.5%	564	10%
Other real estate	173	3.6%	140	3.5%	156	2.7%	119	1.8%	76	1.2%
Consumer:										
Equity loans and lines of credit	419	7.6%	464	8.5%	483	8.5%	500	7.1%	811	8.3%
Consumer and installment	407	4.2%	361	3.4%	369	3.5%	234	2.1%	267	1.8%
Unallocated reserves	68		87		94		110		42	
Total allowance for credit losses	<u>\$ 9,104</u>	<u>100%</u>	<u>\$ 8,778</u>	<u>100.0%</u>	<u>\$ 9,326</u>	<u>100%</u>	<u>\$ 9,610</u>	<u>100%</u>	<u>\$ 8,308</u>	<u>100%</u>

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

As of December 31, 2018, the allowance for credit losses (ALLL) was \$9,104,000, compared to \$8,778,000 at December 31, 2017, a net increase of \$326,000. The increase in the ALLL was due to net recoveries and by a provision for credit losses during the year ended December 31, 2018 which was necessitated by management's observations and assumptions about the existing credit quality of the loan portfolio. Net recoveries totaled \$276,000 while the provision for credit losses was \$50,000. The balance of classified loans and loans graded special mention, totaled \$28,394,000 and \$26,254,000 at December 31, 2018 and \$49,998,000 and \$21,908,000 at December 31, 2017. The balance of undisbursed commitments to extend credit on construction and other loans and letters of credit was \$312,274,000 as of December 31, 2018, compared to \$350,141,000 as of December 31, 2017. At December 31, 2018 and 2017, the balance of a contingent allocation for probable loan loss experience on unfunded obligations was \$225,000 and \$326,000, respectively. The contingent allocation for probable loan loss experience on unfunded obligations is calculated by management using an appropriate, systematic, and consistently applied process. While related to credit losses, this allocation is not a part of ALLL and is considered separately as a liability for accounting and regulatory reporting purposes. Risks and uncertainties exist in all lending transactions and our management and Directors' Loan Committee have established reserve levels based on economic uncertainties and other risks that exist as of each reporting period.

The ALLL as a percentage of total loans was 0.99% at December 31, 2018, and 0.98% at December 31, 2017. Total loans include FLB, SVB and VCB loans that were recorded at fair value in connection with the acquisitions of \$189,719,000 at December 31, 2018 and \$243,712,000 at December 31, 2017. Excluding these acquired loans from the calculation, the ALLL to total gross loans was 1.25% and 1.34% as of December 31, 2018 and 2017, respectively, and general reserves associated with non-impaired loans to total non-impaired loans was 1.25% and 1.34%, respectively. The loan portfolio acquired in the mergers was booked at fair value with no associated allocation in the ALLL. The size of the fair value discount remains adequate for all non-impaired acquired loans; therefore, there is no associated allocation in the ALLL.

The Company's loan portfolio balances in 2018 increased from 2017 through organic growth. Management believes that the change in the allowance for credit losses to total loans ratios is directionally consistent with the composition of loans and the level of nonperforming and classified loans, partially offset by the

general economic conditions experienced in the central California communities serviced by the Company and recent improvements in real estate collateral values.

The determination of the general reserve for loans that are not impaired is based on estimates made by management including, but not limited to, consideration of historical losses (or peer data) by portfolio segment over the most recent 20 quarters, and qualitative factors. Assumptions regarding the collateral value of various under-performing loans may affect the level and allocation of the allowance for credit losses in future periods. The allowance may also be affected by trends in the amount of charge offs experienced or expected trends within different loan portfolios. However, the total reserve rates on non-impaired loans include qualitative factors which are systematically derived and consistently applied to reflect conservatively estimated losses from loss contingencies at the date of the financial statements. Based on the above considerations and given recent changes in historical charge-off rates included in the ALLL modeling and the changes in other factors, management determined that the ALLL was appropriate as of December 31, 2018.

Non-performing loans totaled \$2,740,000 as of December 31, 2018, and \$2,875,000 as of December 31, 2017. The allowance for credit losses as a percentage of nonperforming loans was 332.26% and 305.32% as of December 31, 2018 and December 31, 2017, respectively. In addition, management believes that the likelihood of recoveries on previously charged-off loans continues to improve based on the collection efforts of management combined with improvements in the value of real estate which serves as the primary source of collateral for loans. Management believes the allowance at December 31, 2018 is adequate based upon its ongoing analysis of the loan portfolio, historical loss trends and other factors. However, no assurance can be given that the Company may not sustain charge-offs which are in excess of the allowance in any given period.

GOODWILL AND INTANGIBLE ASSETS

Business combinations involving the Bank's acquisition of the equity interests or net assets of another enterprise give rise to goodwill. Total goodwill at December 31, 2018 was \$53,777,000 consisting of \$13,466,000, \$10,394,000, \$6,340,000, \$14,643,000 and \$8,934,000 representing the excess of the cost of Folsom Lake Bank, Sierra Vista Bank, Visalia Community Bank, Service 1st Bancorp, and Bank of Madera County, respectively, over the net amounts assigned to assets acquired and liabilities assumed in the transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Bank's ability to generate net earnings after the acquisitions and is not deductible for tax purposes. A significant decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed at least annually for impairment.

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GOODWILL AND INTANGIBLE ASSETS (Continued)

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

Goodwill is also tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the Company below its carrying amount. No such events or circumstances arose during the fourth quarter of 2018; therefore, goodwill was not required to be retested.

The intangible assets at December 31, 2018 represent the estimated fair value of the core deposit relationships acquired in the 2017 acquisition of Folsom Lake Bank of \$1,879,000, the 2016 acquisition of Sierra Vista Bank of \$508,000 and the 2013 acquisition of Visalia Community Bank of \$1,365,000. Core deposit intangibles are being amortized using the straight-line method over an estimated life of P5Y to ten years from the date of acquisition. The carrying value of intangible assets at December 31, 2018 was \$2,572,000, net of \$1,180,000 in accumulated amortization expense. The carrying value at December 31, 2017 was \$3,027,000, net of \$725,000 in accumulated amortization expense. Management evaluates the remaining useful lives quarterly to determine whether events or circumstances warrant a revision to the remaining periods of amortization. Based on the evaluation, no changes to the remaining useful lives was required. Management performed an annual impairment test on core deposit intangibles as of September 30, 2018 and determined no impairment was necessary. In addition, management determined that no events had occurred between the annual evaluation date and December 31, 2018 which would necessitate further analysis. Amortization expense recognized was \$455,000 for 2018, \$234,000 for 2017 and \$149,000 for 2016.

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

Years Ending December 31,	Estimated Core Deposit Intangible Amortization
2019	\$ 696
2020	696
2021	661
2022	453
2023	66
Thereafter	-
Total	<u><u>\$ 2,572</u></u>

We have no known foreign deposits. The following table sets forth the average amount of and the average rate paid on certain deposit categories which were in excess of 10% of average total deposits for the years ended December 31, 2018, 2017, and 2016.

(Dollars in thousands)	2018		2017		2016	
	Balance	Rate	Balance	Rate	Balance	Rate
Savings and NOW accounts	<u><u>\$ 383,667</u></u>	<u><u>0.12%</u></u>	<u><u>\$ 382,071</u></u>	<u><u>0.09%</u></u>	<u><u>\$ 337,804</u></u>	<u><u>0.09%</u></u>
Money market accounts	<u><u>\$ 285,568</u></u>	<u><u>0.15%</u></u>	<u><u>\$ 264,581</u></u>	<u><u>0.08%</u></u>	<u><u>\$ 249,620</u></u>	<u><u>0.05%</u></u>
Time certificates of deposit	<u><u>\$ 111,214</u></u>	<u><u>0.25%</u></u>	<u><u>\$ 137,666</u></u>	<u><u>0.30%</u></u>	<u><u>\$ 139,656</u></u>	<u><u>0.38%</u></u>
Non-interest bearing demand	<u><u>\$ 553,305</u></u>	<u><u>-</u></u>	<u><u>\$ 499,987</u></u>	<u><u>-</u></u>	<u><u>\$ 417,151</u></u>	<u><u>-</u></u>
Total deposits	<u><u>\$ 1,333,754</u></u>	<u><u>0.09%</u></u>	<u><u>\$ 1,284,305</u></u>	<u><u>0.08%</u></u>	<u><u>\$ 1,144,231</u></u>	<u><u>0.09%</u></u>

DEPOSITS AND BORROWINGS

The Bank's deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to applicable legal limits. All of a depositor's accounts at an insured depository institution, including all non-interest bearing transactions accounts, will be insured by the FDIC up to the standard maximum deposit insurance amount of \$250,000 for each deposit insurance ownership category.

Total deposits decreased \$143,389,000 or 10.06% to \$1,282,298,000 as of December 31, 2018, compared to \$1,425,687,000 as of December 31, 2017. Interest-bearing deposits decreased \$109,007,000 or 12.97% to \$731,641,000 as of December 31, 2018, compared to \$840,648,000 as of December 31, 2017. Non-interest bearing deposits decreased \$34,382,000 or 5.88% to \$550,657,000 as of December 31, 2018, compared to \$585,039,000 as of December 31, 2017. Average non-interest bearing deposits to average total deposits was 41.48% for the year ended December 31, 2018 compared to 38.93% for the same period in 2017. Based on FDIC deposit market share information published as of June 2018, our total market share of deposits in Fresno, Madera, San Joaquin, and Tulare counties was 3.42% in 2018 compared to 3.69% in 2017. Our total market share in the other counties we operate in (El Dorado, Merced, Placer, Sacramento, and Stanislaus), was less than 1.00% in 2018 and 2017.

The composition of the deposits and average interest rates paid at December 31, 2018 and December 31, 2017 is summarized in the table below.

(Dollars in thousands)	% of December 31, 2018		% of December 31, 2017	
	Total Deposits	Effective Rate	Total Deposits	Effective Rate
NOW accounts	\$ 252,439	19.7%	\$ 296,406	20.8%
MMA accounts	267,820	20.9%	299,638	21.0%
Time deposits	96,817	7.6%	128,070	9.0%
Savings deposits	114,565	8.9%	116,534	8.2%
Total interest-bearing	731,641	57.1%	840,648	59.0%
Non-interest bearing	550,657	42.9%	585,039	41.0%
Total deposits	<u><u>\$ 1,282,298</u></u>	<u><u>100.0%</u></u>	<u><u>\$ 1,425,687</u></u>	<u><u>100.0%</u></u>

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DEPOSITS AND BORROWINGS (Continued)

The following table sets forth the maturity of time certificates of deposit and other time deposits of \$100,000 or more at December 31, 2018.

(In thousands)			
Three months or less	\$ 21,069		
Over 3 through 6 months	10,775		
Over 6 through 12 months	13,813		
Over 12 months	17,459		
	<hr/>		
	<hr/>	\$ 63,116	

As of December 31, 2018, the Company had \$10,000,000 short-term Federal Home Loan Bank (FHLB) of San Francisco advances. As of December 31, 2017, the Company had no short-term or long-term FHLB borrowings. We maintain a line of credit with the FHLB collateralized by government securities and loans. Refer to *Liquidity* section below for further discussion of FHLB advances. The Bank had unsecured lines of credit with its correspondent banks which, in the aggregate, amounted to \$40,000,000 at December 31, 2018 and 2017, at interest rates which vary with market conditions. As of December 31, 2018 and 2017, the Company had no overnight borrowings outstanding under these credit facilities.

CAPITAL RESOURCES

Capital serves as a source of funds and helps protect depositors and shareholders against potential losses. Historically, the primary sources of capital for the Company have been internally generated capital through retained earnings and the issuance of common and preferred stock.

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

Our shareholders' equity was \$219,738,000 as of December 31, 2018, compared to \$209,559,000 as of December 31, 2017. The increase in shareholders' equity is the result of an increase in retained earnings from our net income of \$21,289,000, the exercise of stock options, including the related tax benefit of \$738,000, the effect of share-based compensation expense of \$482,000, stock issued under employee stock purchase plan of \$211,000, offset by a decrease in accumulated other comprehensive income (AOCI) of \$7,233,000, payment of common stock cash dividends of \$4,270,000, repurchase and retirement of common stock of \$894,000, and cumulative effect of accounting change on equity securities of \$144,000.

During 2018, the Bank declared and paid cash dividends to the Company in the amount of \$2,850,000 in connection with the cash dividends to the Company's shareholders approved by the Company's Board of Directors. The Company declared and paid a total of \$4,270,000 or \$0.31 per common share cash dividend to shareholders of record during the year ended December 31, 2018.

During 2017, the Bank declared and paid cash dividends to the Company in the amount of \$3,133,000 in connection with the cash dividends to the Company's shareholders approved by the Company's Board of Directors. The Company declared and paid a total of \$3,010,000 or \$0.24 per common share cash dividend to shareholders of record during the year ended December 31, 2017.

During 2016, the Bank declared and paid cash dividends to the Company in the amount of \$13,010,000 in connection with the cash dividends to the Company's shareholders approved by the Company's Board of Directors and the cash portion of the SVB transaction. The Company declared and paid a total of \$2,715,000 or \$0.24 per common share cash dividend to shareholders of record during the year ended December 31, 2016.

The following table sets forth certain financial ratios for the years ended December 31, 2018, 2017, and 2016.

	2018	2017	2016
Net income:			
To average assets	1.35%	0.94%	1.15%
To average shareholders' equity	10.07%	7.69%	9.84%
Dividends declared per share to net income per share	20.00%	23.53%	19.20%
Average shareholders' equity to average assets	13.40%	12.23%	11.68%

Management considers capital requirements as part of its strategic planning process. The strategic plan calls for continuing increases in assets and liabilities, and the capital required may therefore be in excess of retained earnings. The ability to obtain capital is dependent upon the capital markets as well as our performance. Management regularly evaluates sources of capital and the timing required to meet its strategic objectives.

The Board of Governors, the FDIC and other federal banking agencies have issued risk-based capital adequacy guidelines intended to provide a measure of capital adequacy that reflects the degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets, and transactions, such as letters of credit and recourse arrangements, which are reported as off-balance-sheet items.

The following table presents the Company's regulatory capital ratios as of December 31, 2018 and December 31, 2017.

	Actual Ratio		Minimum regulatory requirement (1)	
	Amount	Ratio	Amount	Ratio
(Dollars in thousands)				
<u>December 31, 2018</u>				
Tier 1 Leverage Ratio	\$ 171,149	11.48%	N/A	N/A
Common Equity Tier 1 Ratio (CET 1)	\$ 166,149	15.13%	N/A	N/A
Tier 1 Risk-Based Capital Ratio	\$ 171,149	15.59%	N/A	N/A
Total Risk-Based Capital Ratio	\$ 180,478	16.44%	N/A	N/A
<u>December 31, 2017</u>				
Tier 1 Leverage Ratio	\$ 153,676	9.71%	\$ 63,338	4.00%
Common Equity Tier 1 Ratio (CET 1)	\$ 149,186	12.90%	\$ 52,081	5.75%
Tier 1 Risk-Based Capital Ratio	\$ 153,676	13.28%	\$ 69,441	7.25%
Total Risk-Based Capital Ratio	\$ 162,780	14.07%	\$ 92,588	9.25%

(1) The 2017 minimum regulatory requirement threshold includes the capital conservation buffer of 1.250%.

The following table presents the Bank's regulatory capital ratios as of December 31, 2018 and December 31, 2017.

	Actual Ratio		Minimum regulatory requirement (1)	
	Amount	Ratio	Amount	Ratio
(Dollars in thousands)				
<u>December 31, 2018</u>				
Tier 1 Leverage Ratio	\$ 168,770	11.32%	\$ 59,639	4.00%
Common Equity Tier 1 Ratio (CET 1)	\$ 168,770	15.38%	\$ 49,388	6.38%
Tier 1 Risk-Based Capital Ratio	\$ 168,770	15.38%	\$ 65,850	7.88%
Total Risk-Based Capital Ratio	\$ 178,099	16.23%	\$ 87,800	9.88%
<u>December 31, 2017</u>				
Tier 1 Leverage Ratio	\$ 149,779	9.46%	\$ 63,332	4.00%
Common Equity Tier 1 Ratio (CET 1)	\$ 149,779	12.96%	\$ 52,040	5.75%
Tier 1 Risk-Based Capital Ratio	\$ 149,779	12.96%	\$ 69,387	7.25%
Total Risk-Based Capital Ratio	\$ 158,882	13.74%	\$ 92,516	9.25%

(1) The 2018 and 2017 minimum regulatory requirement threshold includes the capital conservation buffer of 1.250% and 0.625%, respectively. These ratios are not reflected on a fully phased-in basis, which will occur in January 2019.

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CAPITAL RESOURCES (Continued)

The Company succeeded to all of the rights and obligations of the Service 1st Capital Trust I, a Delaware business trust, in connection with the acquisition of Service 1st as of November 12, 2008. The Trust was formed on August 17, 2006 for the sole purpose of issuing trust preferred securities fully and unconditionally guaranteed by Service 1st. Under applicable regulatory guidance, the amount of trust preferred securities that is eligible as Tier 1 capital is limited to 25% of the Company's Tier 1 capital on a pro forma basis. At December 31, 2018, all of the trust preferred securities that have been issued qualify as Tier 1 capital. The trust preferred securities mature on October 7, 2036, are redeemable at the Company's option beginning five years after issuance, and require quarterly distributions by the Trust to the holder of the trust preferred securities at a variable interest rate which will adjust quarterly to equal the three month LIBOR plus 1.60%.

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

The Notes may be declared immediately due and payable at the election of the trustee or holders of 25% of the aggregate principal amount of outstanding Notes in the event that the Company defaults in the payment of any interest following the nonpayment of any such interest for 20 or more consecutive quarterly periods. Holders of the trust preferred securities are entitled to a cumulative cash distribution on the liquidation amount of \$1,000 per security. For each January 7, April 7, July 7 or October 7 of each year, the rate will be adjusted to equal the three month LIBOR plus 1.60%. As of December 31, 2018, the rate was 4.04%. Interest expense recognized by the Company for the years ended December 31, 2018, 2017, and 2016 was \$199,000, \$147,000 and \$121,000, respectively.

LIQUIDITY

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

Our primary sources of liquidity are derived from financing activities which include the acceptance of customer and, to a lesser extent, broker deposits, Federal funds facilities and advances from the Federal Home Loan Bank of San Francisco (FHLB). These funding sources are augmented by payments of principal and interest on loans, the routine maturities and pay downs of securities from the securities portfolio, the stability of our core deposits and the ability to sell investment securities. As of December 31, 2018, the Company had unpledged securities totaling \$391,497,000 available as a secondary source of liquidity and total cash and cash equivalents of \$31,727,000. Cash and cash equivalents at December 31, 2018 decreased 68.39% compared to December 31, 2017. Primary uses of funds include withdrawal of and interest payments on deposits, origination and purchases of loans, purchases of investment securities, and payment of operating expenses.

To augment our liquidity, we have established Federal funds lines with various correspondent banks. At December 31, 2018, our available borrowing capacity includes approximately \$40,000,000 in Federal funds lines with our correspondent banks and \$286,934,000 in unused FHLB advances. At December 31, 2018, we were not aware of any information that was reasonably likely to have a material effect on our liquidity position.

The following table reflects the Company's credit lines, balances outstanding, and pledged collateral at December 31, 2018 and 2017:

	December 31, 2018	December 31, 2017
Credit Lines (In thousands)		
Unsecured Credit Lines (interest rate varies with market):		
Credit limit	\$ 40,000	\$ 40,000
Balance outstanding	\$ -	\$ -
Federal Home Loan Bank (interest rate at prevailing interest rate):		
Credit limit	\$ 286,934	\$ 234,689
Balance outstanding	\$ 10,000	\$ -
Collateral pledged	\$ 448,083	\$ 357,393
Fair value of collateral	\$ 399,027	\$ 316,160
Federal Reserve Bank (interest rate at prevailing discount interest rate):		
Credit limit	\$ 4,364	\$ 6,740
Balance outstanding	\$ -	\$ -
Collateral pledged	\$ 4,498	\$ 7,431
Fair value of collateral	\$ 4,475	\$ 7,437

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

OFF-BALANCE SHEET ITEMS

In the normal course of business, the Company is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received. The balance of commitments to extend credit on undisbursed construction and other loans and letters of credit was \$312,274,000 as of December 31, 2018 compared to \$350,141,000 as of December 31, 2017. For a more detailed discussion of these financial instruments, see Note 12 to the audited Consolidated Financial Statements in this Annual Report.

Contractual Obligations

The contractual obligations of the Company, summarized by type of obligation and contractual maturity, at December 31, 2018, are as follows:

(In thousands)	Less Than One Year	One to Three Years	Three to Five Years	After Five Years	Total
Deposits	\$ 1,257,349	\$ 21,318	\$ 2,521	\$ 1,110	\$ 1,282,298
Subordinated notes	-	-	-	5,155	5,155
Operating leases	2,384	3,883	3,000	4,334	13,601
Total	<u>\$ 1,259,733</u>	<u>\$ 25,201</u>	<u>\$ 5,521</u>	<u>\$ 10,599</u>	<u>\$ 1,301,054</u>

Deposits represent both non-interest bearing and interest bearing deposits. Interest bearing deposits include interest bearing transaction accounts, money market and savings deposits and certificates of deposit. Deposits with indeterminate maturities, such as demand, savings and money market accounts are reflected as obligations due in less than one year.

Subordinated notes issued to a capital trust which was formed solely for the purpose of issuing trust preferred securities. These subordinated notes were acquired as a part of the merger with Service 1st. The aggregate amount indicated above represents the full amount of the contractual obligation. All of these securities are variable rate instruments. The trust preferred securities mature on October 7, 2036, and are redeemable quarterly at the Company's option.

Management's Discussion and Analysis

of Financial Condition and Results of Operations.

OFF-BALANCE SHEET ITEMS (Continued)

In the ordinary course of business, the Company is party to various operating leases. For operating leases, the dollar balances reflected in the table above are categorized by the due date of the lease payments. Operating leases represent the total minimum lease payments under non-cancelable operating leases.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in accordance with the accounting principles generally accepted in the United States ("U.S. GAAP") requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expense in the financial statements. Various elements of our accounting policies, by their nature, involve the application of highly sensitive and judgmental estimates and assumptions. Some of these policies and estimates relate to matters that are highly complex and contain inherent uncertainties. It is possible that, in some instances, different estimates and assumptions could reasonably have been made and used by management, instead of those we applied, which might have produced different results that could have had a material effect on the financial statements.

We have identified the following accounting policies and estimates that, due to the inherent judgments and assumptions and the potential sensitivity of the financial statements to those judgments and assumptions, are critical to an understanding of our financial statements. We believe that the judgments, estimates and assumptions used in the preparation of the Company's financial statements are appropriate. For a further description of our accounting policies, see *Note 1—Summary of Significant Accounting Policies* in the financial statements included in this Form 10-K.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Allowance for Credit Losses

Our allowance for credit losses is an estimate of probable incurred losses in the loan portfolio. Loans are charged-off against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for credit losses. Management's methodology for estimating the allowance balance consists of several key elements, which include specific allowances on individual impaired loans and the formula driven allowances on pools of loans with similar risks. The allowance is only an estimate of the inherent loss in the loan portfolio and may not represent actual losses realized over time, either of losses in excess of the allowance or of losses less than the allowance. Our accounting for estimated loan losses is discussed and disclosed primarily in *Note 1* and *5* to the consolidated financial statements under the heading "*Allowance for Credit Losses*".

Business Combinations

The Company accounts for acquisitions of businesses using the acquisition method of accounting. Under the acquisition method, assets acquired and liabilities assumed are recorded at their estimated fair values at the date of acquisition. This fair value may differ from the cost basis recorded on the acquired institution's financial statements. Management performs an initial assessment to determine which assets and liabilities must be designated for fair value analysis. Management typically engages experts in the field of valuation to perform the valuation of significant assets and liabilities and, after assessing the

resulting fair value computation, will utilize such value in computing the initial purchase accounting adjustments for the acquired assets. It is possible that these values could be viewed differently through alternative valuation approaches or if performed by different experts. Management is responsible for determining that the values derived by experts are reasonable. Any excess of the purchase price over amounts allocated to the acquired assets, including identifiable intangible assets, and liabilities assumed is recorded as goodwill. The fair values of assets acquired and liabilities assumed are subject to adjustment during the first twelve months after the acquisition date if additional information becomes available to indicate a more accurate or appropriate value for an asset or liability. See *Note 1*—under the heading "*Business Combinations*", and *Note 7—Goodwill and Intangible Assets* in the financial statements in this Form 10-K.

Goodwill and Other Intangible Assets

Goodwill and intangible assets are evaluated at least annually for impairment or more frequently if events or circumstances, such as changes in economic or market conditions, indicate that impairment may exist. When required, the goodwill impairment test involves a two-step process. The first test for goodwill impairment is done by comparing the reporting unit's aggregate fair value to its carrying value. Absent other indicators of impairment, if the aggregate fair value exceeds the carrying value, goodwill is not considered impaired and no additional analysis is necessary. If the carrying value of the reporting unit were to exceed the aggregate fair value, a second test would be performed to measure the amount of impairment loss, if any. To measure any impairment loss, the implied fair value would be determined in the same manner as if the reporting unit were being acquired in a business combination. If the implied fair value of goodwill is less than the recorded goodwill, an impairment charge would be recorded for the difference.

During 2011, the Financial Accounting Standards Board issued Accounting Standards Update ("ASU") 2011-08, Intangibles-Goodwill and Other (Topic 350). Under the ASU, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. Thus, before the first step of goodwill impairment, the entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that the fair value of goodwill is less than carrying value. The qualitative assessment includes, but is not limited to, macroeconomic and State of California economic conditions, industry and market conditions and trends, the Company's financial performance, market capitalization, stock price, and any Company-specific events relevant to the assessment. If after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step process is unnecessary. As of December 31, 2018, based on our qualitative assessment, there were no reporting units where we believed that it was more likely than not that the fair value of a reporting unit was less than its carrying amount, including goodwill. As a result, we had no reporting units where there was a reasonable possibility of failing Step 1 of the goodwill impairment test.

See *Note 7—Goodwill and Intangible Assets* in the financial statements in this Form 10-K for further discussion.

INFLATION

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

At December 31, 2018, we do not believe that inflation will have a material impact on our consolidated financial position or results of operations. However, if inflation concerns cause short term rates to rise in the near future, we may benefit by immediate repricing of a portion of our loan portfolio. Refer to Quantitative and Qualitative Disclosures About Market Risk for further discussion.

Quantitative and Qualitative Disclosures About Market Risk

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

We realize income principally from the differential or spread between the interest earned on loans, investments, other interest-earning assets and the interest incurred on deposits and borrowings. The volumes and yields on loans, deposits and borrowings are affected by market interest rates. As of December 31, 2018, 72.44% of our loan portfolio was tied to adjustable-rate indices. The majority of our adjustable rate loans are tied to prime and reprice within 90 days. Several of our loans, tied to prime, are at their floors and will not reprice until prime plus the factor is greater than the floor. The majority of our time deposits have a fixed rate of interest. As of December 31, 2018, 75.36% of our time deposits mature within one year or less.

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

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

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

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

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

The assets and liabilities of a financial institution are primarily monetary in nature. As such they represent obligations to pay or receive fixed and determinable amounts of money that are not affected by future changes in prices. Generally, the impact of inflation on a financial institution is reflected by fluctuations in interest rates, the ability of customers to repay their obligations and upward pressure on operating expenses. Although inflationary pressures are not considered to be of any particular hindrance in the current economic environment, they may have an impact on the company's future earnings in the event those pressures become more prevalent.

As a financial institution, the Company's primary component of market risk is interest rate volatility. Fluctuations in interest rates will ultimately impact both the level of interest income and interest expense recorded on a large portion of the Company's assets and liabilities, and the market value of all interest earning assets and interest bearing liabilities, other than those which possess a short term

to maturity. Virtually all of the Company's interest earning assets and interest bearing liabilities are located at the Bank level. Thus, virtually all of the Company's interest rate risk exposure lies at the Bank level other than \$5.2 million in subordinated notes issued by the Company's subsidiary, Service 1st Capital Trust I. As a result, all significant interest rate risk procedures are performed at the Bank level.

The fundamental objective of the Company's management of its assets and liabilities is to maximize the Company's economic value while maintaining adequate liquidity and an exposure to interest rate risk deemed by management to be acceptable. Management believes an acceptable degree of exposure to interest rate risk results from the management of assets and liabilities through maturities, pricing and mix to attempt to neutralize the potential impact of changes in market interest rates. The Company's profitability is dependent to a large extent upon its net interest income, which is the difference between its interest income on interest earning assets, such as loans and investments, and its interest expense on interest bearing liabilities, such as deposits and borrowings. The Company is subject to interest rate risk to the degree that its interest earning assets re-price differently than its interest bearing liabilities. The Company manages its mix of assets and liabilities with the goals of limiting its exposure to interest rate risk, ensuring adequate liquidity, and coordinating its sources and uses of funds.

The Company seeks to control interest rate risk exposure in a manner that will allow for adequate levels of earnings and capital over a range of possible interest rate environments. The Company has adopted formal policies and practices to monitor and manage interest rate risk exposure. Management believes historically it has effectively managed the effect of changes in interest rates on its operating results and believes that it can continue to manage the short-term effects of interest rate changes under various interest rate scenarios.

Management employs asset and liability management software and engages consultants to measure the Company's exposure to future changes in interest rates. The software measures the expected cash flows and re-pricing of each financial asset/liability separately in measuring the Company's interest rate sensitivity. Based on the results of the software's output, management believes the Company's balance sheet is evenly matched over the short term and slightly asset sensitive over the longer term as of December 31, 2018. This means that the Company would expect (all other things being equal) to experience a limited change in its net interest income if rates rise or fall. The level of potential or expected change indicated by the tables below is considered acceptable by management and is compliant with the Company's ALCO policies. Management will continue to perform this analysis each quarter.

The hypothetical impacts of sudden interest rate movements applied to the Company's asset and liability balances are modeled quarterly. The results of these models indicate how much of the Company's net interest income is "at risk" from various rate changes over a one year horizon. This exercise is valuable in identifying risk exposures. Management believes the results for the Company's December 31, 2018 balances indicate that the net interest income at risk over a one year time horizon for a 100 basis points ("bps"), 200 bps, 300 bps, and 400 bps rate increase and a 100 bps decrease is acceptable to management and within policy guidelines at this time. Given the low interest rate environment, 200 bps, 300 bps, and 400 bps decreases are not considered a realistic possibility and are therefore not modeled.

The results in the table below indicate the change in net interest income the Company would expect to see as of December 31, 2018, if interest rates were to change in the amounts set forth:

Sensitivity Analysis of Impact of Rate Changes on Interest Income

Hypothetical Change in Rates (Dollars in thousands)	Projected Net Interest Income	\$ Change from Rates at December 31, 2018	% Change from Rates at December 31, 2018
Up 400 bps	\$ 67,200	\$ 2,300	3.54%
Up 300 bps	66,500	1,600	2.47%
Up 200 bps	65,500	600	0.92%
Up 100 bps	65,200	300	0.46%
Unchanged	64,900	-	-
Down 100 bps	60,900	(4,000)	(6.16)%

It is important to note that the above table is a summary of several forecasts and actual results may vary from any of the forecasted amounts and such difference may be material and adverse. The forecasts are based on estimates and

Quantitative and Qualitative Disclosures About Market Risk

assumptions made by management, and that may turn out to be different, and may change over time. Factors affecting these estimates and assumptions include, but are not limited to: 1) competitor behavior, 2) economic conditions both locally and nationally, 3) actions taken by the Federal Reserve Board, 4) customer behavior and 5) management's responses to each of the foregoing. Factors that vary significantly from the assumptions and estimates may have material and adverse effects on the Company's net interest income; therefore, the results of this analysis should not be relied upon as indicative of actual future results.

The following table shows management's estimates of how the loan portfolio is segregated between variable-daily, variable other than daily and fixed rate loans, and estimates of re-pricing opportunities for the entire loan portfolio at December 31, 2018 and 2017:

Rate Type (Dollars in thousands)	December 31, 2018		December 31, 2017	
	Balance	Percent of Total	Balance	Percent of Total
Variable rate	\$ 664,313	72.44%	\$ 634,900	70.60%
Fixed rate	252,790	27.56%	264,420	29.40%
Total gross loans	\$ 917,103	100.00%	\$ 899,320	100.00%

Approximately 72.44% of our loan portfolio is tied to adjustable rate indices and 32.35% of our loan portfolio reprices within 90 days. As of December 31,

2018, we had 2,041 commercial and real estate loans totaling \$546,984,000 with floors ranging from 3.25% to 7.50% and ceilings ranging from 6.00% to 30.00%.

The following table shows the repricing categories of the Company's loan portfolio at December 31, 2018 and 2017:

Repricing (Dollars in thousands)	December 31, 2018		December 31, 2017	
	Balance	Percent of Total	Balance	Percent of Total
< 1 Year	\$ 334,910	36.52%	\$ 318,985	35.47%
1-3 Years	199,004	21.70%	177,545	19.74%
3-5 Years	261,299	28.49%	200,471	22.29%
> 5 Years	121,890	13.29%	202,319	22.50%
Total gross loans	\$ 917,103	100.00%	\$ 899,320	100.00%

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

Stock Price Information

The Company's common stock is listed for trading on the NASDAQ Capital Market under the ticker symbol CVCY. As of March 8, 2019, the Company had approximately 1,072 shareholders of record.

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

<u>Quarter Ended</u>	Sales Prices for the Company's Common Stock	
	<u>Low</u>	<u>High</u>
March 31, 2017	\$ 18.42	\$ 22.44
June 30, 2017	17.62	23.94
September 30, 2017	18.57	23.28
December 31, 2017	19.06	22.75
March 31, 2018	18.05	21.70
June 30, 2018	19.02	22.34
September 30, 2018	20.82	22.14
December 31, 2018	15.66	21.89

The Company paid common share cash dividends of \$0.31 and \$0.24 per share in 2018 and 2017, respectively. The Company's primary source of income with which to pay cash dividends are dividends from the Bank. See Note 13 in the audited Consolidated Financial Statements of this Annual Report.

SHAREHOLDER INQUIRIES

Inquiries regarding Central Valley Community Bancorp's accounting, internal accounting controls or auditing concerns should be directed to Steven D. McDonald, chairman of the Board of Directors' Audit Committee, at steve.mcdonald@cvcb.com, anonymously at www.ethicspoint.com or by calling Ethics Point, Inc. at (866) 294-9588. General inquiries about the Company or the Bank should be directed to LeAnn Ruiz, Assistant Corporate Secretary at (800) 298-1775.



Investing in What's Important: Community.

59 Days Of Code
Ag Lenders Society of California

Agape Inc.

Allied Grape Growers

American Bankers Association

American Cancer Society

American Heart Association

American Institute of Certified Public Accountants

American Legion District 15

American Pistachio Growers

Angels For Hearts

Assistance League Fresno

Association of Commercial Real Estate

Auberry Intermountain Rotary Club

Better Business Bureau

Big Sandy Rancheria Band of the Western Mono Indians

BoeFly

Boys & Girls Clubs of El Dorado County

Breathe California Sacramento Region

Building Industry Association of Tulare and Kings County

Business Organization of Old Town

Cal Sparks Extreme Basketball

California Agricultural Leadership Foundation

California Armenian Home

California Association of Mortgage Professionals

California Bankers Association

California Cancer Associates for Research

& Excellence Connects Foundation

California Chamber of Commerce

California Department of Insurance

California Financial Crimes Investigators Association

California Food Expo

California Fresh Fruit Association

California Medical Group Management Association

California Society of Certified Public Accountants

California State University, Fresno – Ag One Foundation

California State University, Fresno – Bulldog Foundation

California State University, Fresno – Craig School of Business

California State University, Fresno – Foundation

California State University, Fresno - Jordan College of Agricultural Sciences & Technology

California State University, Fresno – Lyles Center for Innovation and Entrepreneurship

California State University, Fresno – Maddy Institute

California State University, Fresno – Student Cupboard

California Tomato Growers Association

Californians For Financially Responsible Government

Cappuccino Cruisers Classic Car Club

CARR 4 Kids, Inc., Community At Risk Resources

Cathedral of the Annunciation School of Stockton

Central California Food Bank

Central California Society For Human Resource Management

Central California Society for Prevention of Cruelty to Animals

Central California Women's Conference

Central Sierra Historical Society

Central Valley Christian Schools

Central Valley Community Foundation

Central Valley Recovery Services Inc.

Central Valley SCORE

Child Abuse Prevention Council of San Joaquin County

Children's Musical Theaterworks

Citrus Heights Chamber of Commerce

City of Folsom Parks & Recreation

Clovis American Legion Post #147

Clovis Chamber of Commerce

Clovis Community Foundation

Clovis Rodeo Association

Coarsegold Chamber of Commerce

Coarsegold Community Center

Commercial Real Estate Women Network Foundation

Community Foundation of Orangevale & Fair Oaks

Community Partnership For Families of San Joaquin

Court Appointed Special Advocates of Fresno & Madera Counties

Cultural Arts Rotary Club of Fresno

Cystic Fibrosis Foundation

Diocese of Fresno Education Corporation

Doug McDonald Scholarship

Downtown Visalia Foundation

Economic Development Corporation

El Capitan High School

El Dorado Food Bank

El Dorado Hills Chamber of Commerce

El Dorado Park Community Development Corporation

Emergency Food Bank of Greater Stockton

EVERFI

Exceptional Parents Unlimited Children's Center

Executives Association of Tulare County

Exeter By Design Foundation

Exeter Chamber of Commerce

Fair Oaks Chamber of Commerce

Fair Oaks Historical Society

Fair Oaks Recreation and Park District

Fi360, Inc.

Financial Credit Networks, Inc.

Financial Services Information Sharing and Analysis Center

Folsom American Little League Baseball

Folsom Chamber of Commerce

Folsom Cordova Community Partnership

Folsom High School

Folsom Historic District

Folsom Historical Society

Folsom Lake Community Concert Association

Folsom, El Dorado & Sacramento Historical Railroad Association

Foothill Elementary School

Foundation For Clovis Schools

Foundation For Firebaugh - Las Deltas Unified Schools

Fresno Area Community Enterprises

Fresno Area Hispanic Foundation

Fresno Art Museum

Fresno Association of REALTORS

Fresno Business Council

Fresno Chamber Of Commerce

Fresno County Farm Bureau
Fresno Economic Opportunities Commission
Fresno Fire Chiefs Foundation
Fresno Metro Black Chamber of Commerce
Fresno Metro Ministry
Fresno Philharmonic
Fresno Rescue Mission
Goldenrod Elementary School
Grand Theatre Center For The Arts
Greater Stockton Chamber of Commerce
Habitat For Humanity
Haven Women's Center of Stanislaus
Hawkins School of Performing Arts
Ideasworks Makerspaces
ImagineU Children's Museum
Independent Community Bankers of America
Information Systems Audit and Control Association
International Soap Box Derby
Investor's Business Daily
Kaweah Delta Hospital Foundation
Kerman Boys Basketball Boosters
Kerman Chamber of Commerce
Kerman High School
Kerman Senior Center
Kings County Farm Bureau
Kiwanis Club of Rancho Cordova
Leukemia & Lymphoma Society Central California Chapter
Life Skills Training and Educational Programs
Lodi Boys & Girls Club
Lodi Chamber of Commerce
Lodi Police Foundation
Lodi Tokay Rotary Club
Loel Senior Center and Gardens
Love Inc.
Made For Them
Madera Chamber of Commerce
Madera Community Hospital Foundation
Madera County Ag Boosters
Madera County Farm Bureau
Madera County Food Bank
Madera Elementary Foundation
Madera National Little League
Marjaree Mason Center
MBX Systems
Merced College Agricultural Ambassador Program
Merced County Fair
Merced County Farm Bureau
Merced County Food Bank
Modesto Chamber of Commerce
Muscular Dystrophy Association
National Association of Government Guaranteed Lenders
National Mortgage Licensing System
Neighborhood Industries
Oakdale Educational Foundation
Oakhurst Area Chamber of Commerce
Orchard Ranch Elementary School
Park of The Sierras
Pine Ridge Elementary Boosters
Placer Care Coalition Inc.
Placer County Clerk Recorder
Placer Food Bank
Placer Society for Prevention of Cruelty to Animals
Placerville Kiwanis Club
Poverello House
Rancho Cordova Chamber of Commerce
Ray of Hope A Valley Teen Ranch Organization
Read For Life
Real Authentic Women Wellness
Ronald McDonald House Charities
Roseville Area Chamber of Commerce
Roseville Theatre Arts Academy
Rotary Club of Clovis
Rotary Club of Fair Oaks
Rotary Club of Folsom
Rotary Club of Fresno
Rotary Club of Kerman
Rotary Club of Madera
Rotary Club of Oakhurst Sierra
Rotary Club of Rancho Cordova
Rotary Club of Roseville
Rotary Club of Sacramento
Rotary International
Sacramento Black Chamber of Commerce
Sacramento County Clerk Recorder
Sacramento Food Bank & Family Services
Sacramento Housing Alliance
Sacramento Master Singers
Sacramento Metropolitan Chamber of Commerce
Sacramento Regional Builders Exchange
Sacramento SCORE
Saint Agnes Foundation
San Joaquin AgFest
San Joaquin Asparagus Festival
San Joaquin Dental Society
San Joaquin Farm Bureau Federation
San Joaquin River Parkway and Conservation Trust, Inc.
San Joaquin Valley Manufacturing Alliance
Second Harvest Food Bank
Sequoia Council of the Boy Scouts of America
Shingle Springs Cameron Park Chamber of Commerce
Sierra Foothill Conservancy
Sierra High School
Sierra Lions Club
Sierra Women's Service Club
Signature User Group
Soroptimist International of The Sierras
St. Hope Academy
St. Joachim Catholic Church
St. John's Cathedral
St. Jude Children's Research Hospital
Stanislaus County Farm Bureau
State of California Department of Consumer Affairs
Stockton Athletic Hall Of Fame
Stockton Shelter For The Homeless
Stocktonians Taking Action to Neutralize Drugs
Stone Ministries Inc.
Sutter Roseville Medical Center
Sutter Street Theatre
Sycamore Valley Academy
The Bank CEO Network
The Buddhist Church of Stockton
The Business Journal
The Downtown Fresno Partnership
The Exeter Art Gallery & Museum
The First Tee Of Fresno
The Leukemia & Lymphoma Society Inc.
The Risk Management Association
The Risk Management Association – Fresno Chapter
The Risk Management Association – Sacramento Chapter
The Salvation Army
Tracy Sunrise Rotary
Tulare County Farm Bureau
Twilight Haven
Twin Lakes Food Bank
Union Mine High School
United Way of Fresno and Madera Counties
United Way of San Joaquin County
United Way of Stanislaus County
United Way of Tulare County
Valley Children's Healthcare
Valley Children's Healthcare Alegria Guild
Valley Crime Stoppers
Visalia Breakfast Lions Club
Visalia Chamber of Commerce
Visalia Economic Development Corporation
Visalia Runners – Road Runners Club of America
West Visalia Kiwanis Club
Western Payments Alliance
Women's Spotlight Network
Yosemite Badger Youth Football



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Customer Service

(800) 298-1775
(559) 298-1775

Cameron Park

3311 Coach Lane
Cameron Park, CA 95682
(530) 676-3400

Clovis

Clovis Main
600 Pollasky Avenue
Clovis, CA 93612
(559) 323-3480

Herndon & Fowler

1795 Herndon Avenue,
Suite 101
Clovis, CA 93611
(559) 323-2200

Exeter

300 East Pine Street
Exeter, CA 93221
(559) 594-9919

Folsom

905 Sutter Street,
Suite 100
Folsom, CA 95630
(916) 985-8700

Fresno

Corporate Office
7100 North Financial Drive,
Suite 101
Fresno, CA 93720
(559) 298-1775

Fig Garden Village
5180 North Palm,
Suite 105
Fresno, CA 93704
(559) 221-2760

Fresno Downtown
2404 Tulare Street
Fresno, CA 93721
(559) 268-6806

River Park

8375 North Fresno Street
Fresno, CA 93720
(559) 447-3350

Gold River

11230 Gold Express Drive,
Suite 311
Gold River, CA 95670
Opening in June 2019

Kerman

360 South Madera Avenue
Kerman, CA 93630
(559) 842-2265

Lodi

1901 West Kettleman Lane,
Suite 100
Lodi, CA 95242
(209) 333-5000

Madera

1919 Howard Road
Madera, CA 93637
(559) 673-0395

Merced

3337 G Street,
Suite B
Merced, CA 95340
(209) 725-2820

Modesto

2020 Standiford Avenue,
Suite H
Modesto, CA 95350
(209) 576-1402

Oakhurst

40004 Highway 41,
Suite 101
Oakhurst, CA 93644
(559) 642-2265

Prather

29430 Auberry Road
Prather, CA 93651
(559) 855-4100

Roseville

2999 Douglas Boulevard,
Suite 160
Roseville, CA 95661
(916) 859-2550

Stockton

2800 West March Lane,
Suite 120
Stockton, CA 95219
(209) 956-7800

Visalia

Floral
120 North Floral Street
Visalia, CA 93291
(559) 625-8733

Mission Oaks Plaza

5412 Avenida de los Robles
Visalia, CA 93291
(559) 730-2851

Business Lending

7100 North Financial Drive,
Suite 101
Fresno, CA 93720
(559) 298-1775
(800) 298-1775

Agribusiness

1044 East Herndon Avenue,
Suite 106
Fresno, CA 93720
(559) 323-3493

Real Estate

1044 East Herndon Avenue,
Suite 106
Fresno, CA 93720
(559) 323-3365

SBA Lending

7100 N. Financial Drive,
Suite 101
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(559) 323-3384



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