UNITED SECURITY BANCSHARES
Form 10-Q/A
September 07, 2012

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q
(Amendment No. 1)

xQUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2012

oTRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM______ TO .

Commission file number: 000-32987

UNITED SECURITY BANCSHARES
(Exact name of registrant as specified in its charter)

CALIFORNIA	91-2112732
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2126 Inyo Street, Fresno, California	93721
(Address of principal executive offices)	(Zip Code)

Registrants telephone number, including area code (559) 248-4943

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing for the past 90 days.
Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yesx No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).
Large accelerated filer o Accelerated filer o Non-accelerated filer o Small reporting company x

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

Aggregate market value of the Common Stock held by non-affiliates as of the last business day of the registrant's most recently completed second fiscal quarter - June 30, 2012: $32,991,096

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

Common Stock, no par value
(Title of Class)

Shares outstanding as of July 31, 2012: 13,803,806

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Explanatory Note

The sole purpose of this Amendment No. 1 to the Company's Form 10-Q for the quarter ended June 30, 2012, originally filed with the United States Securities and Exchange Commission (SEC) on August 14, 2012 (the Initial Form 10-Q), is to furnish Exhibit 101 to the Initial Form 10-Q. Exhibit 101 contains the XBRL (eXtensible Business Reporting Language) interactive data files for the financial statements and notes included in Part I, Item 1 of the Form 10-Q. As permitted by Rule 405(a)(2) of Regulation S-T, Exhibit 101 is being furnished by amendment within 30 days of the first quarterly period in which detailed footnote tagging is required.

No other changes have been made to the Initial Form 10-Q and the Initial Form 10-Q has not been updated to reflect events occurring subsequent to the original filing date.

PART I. Financial Information

United Security Bancshares and Subsidiaries
Consolidated Balance Sheets – (unaudited)
June 30, 2012 and December 31, 2011

(in thousands except shares)	June 30, 2012	December 31, 2011
Assets		
Cash and due from banks	$22,400	$28,052
Cash and due from FRB	76,990	96,132
Cash and cash equivalents	99,390	124,184
Interest-bearing deposits in other banks	2,103	2,187
Investment securities available for sale (at fair value)	35,553	38,458
Loans and leases	395,081	408,715
Unearned fees	(518)	(569)
Allowance for credit losses	(11,610)	(13,648)
Net loans	382,953	394,498
Accrued interest receivable	1,755	1,946
Premises and equipment – net	12,566	12,675
Other real estate owned	23,894	27,091
Intangible assets	383	553
Goodwill	4,488	4,488
Cash surrender value of life insurance	16,413	16,150
Investment in limited partnerships	3,677	4,149
Deferred income taxes - net	11,153	11,485 11,485
Other assets	11,279	13,468
Total assets	$605,607	$651,332
Liabilities & Shareholders' Equity		
Liabilities		
Deposits		
Noninterest bearing	$197,052	$224,907
Interest bearing	327,950	349,520
Total deposits	525,002	574,427
Accrued interest payable	95	111

Accounts payable and other liabilities	5,417	5,594
Junior subordinated debentures (at fair value)	9,276	9,027
Total liabilities	539,790	589,159
Shareholders' Equity		
Common stock, no par value 20,000,000 shares authorized, 13,803,806 and 13,531,832 issued and outstanding, in 2012 and 2011, respectively	42,087	41,435
Retained earnings	24,029	21,447
Accumulated other comprehensive loss	(299)	(709)
Total shareholders' equity	65,817	62,173
Total liabilities and shareholders' equity	$605,607	$651,332

See notes to consolidated financial statements;;

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United Security Bancshares and Subsidiaries
Consolidated Statements of Operations and Comprehensive Income
(Unaudited)

(In thousands except shares and EPS)	Quarter Ended June 30, 2012	Quarter Ended June 30, 2011 (As restated)	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011(As restated)
Interest Income:				
Loans, including fees	$5,966	$ 6,437	$12,009	$ 12,857
Investment securities – AFS – taxable	457	540	978	1,137
Interest on deposits in FRB	43	43	94	94
Interest on deposits in other banks	10	10	20	20
Total interest income	6,476	7,030	13,101	14,108
Interest Expense:				
Interest on deposits	437	668	915	1,436
Interest on other borrowings	72	83	136	168
Total interest expense	509	751	1,051	1,604
Net Interest Income Before Provision for Credit Losses	5,967	6,279	12,050	12,504
Provision for Credit Losses	1,004	9,161	1,006	10,051
Net Interest Income	4,963	(2,882)	11,044	2,453
Noninterest Income:				
Customer service fees	897	894	1,801	1,761
Increase in cash surrender value of bank-owned life insurance	144	140	280	281
Gain (Loss) on sale of other real estate owned	275	(324)	337	(44)
Gain (Loss) on fair value of financial liability	364	222	(112)	(145)
Gain on sale of other investment	1,807	0	1,807	0
Other	177	242	445	449
Total noninterest income	3,664	1,174	4,558	2,302
Noninterest Expense:				
Salaries and employee benefits	2,176	2,220	4,598	4,541
Occupancy expense	840	909	1,605	1,802
Data processing	19	19	37	43
Professional fees	439	980	683	1,419
FDIC/DFI insurance assessments	417	475	783	988
Director fees	69	58	136	116
Amortization of intangibles	79	158	170	320
Correspondent bank service charges	80	78	160	154
Impairment loss on core deposit intangible	0	0	0	36
Impairment loss on goodwill	0	1,489	0	1,489
Impairment loss on investment securities (cumulative total other-than-temporary loss of $3.6 million,net of $1.3 million recognized in other comprehensive loss, pre-tax)	149	0	172	0
Impairment loss on OREO	0	438	0	1,122
Loss on California tax credit partnership	81	103	184	209
OREO expense	(18)	719	666	951
Other	646	594	1,272	1,107

Total noninterest expense	4,977	8,240	10,466	14,297
Income (Loss) Before Provision for Taxes	3,650	(9,948)	5,136	(9,542)
Provision (Benefit)for Taxes on Income	1,478	(3,599)	1,912	(3,549)
Net Income (Loss)	$2,172	$ (6,349)	$3,224	$ (5,993)
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) on available for sale securities, and past service costs of employee benefit plans – net of income tax expense (benefit) of $237, $(282), $273 and $(305).	355	(423)	410	(458)
Comprehensive Income (Loss)	$2,527	$ (6,772)	$3,634	$ (6,451)
Net Income (Loss) per common share				
Basic	$0.16	$ (0.46)	$0.23	$ (0.43)
Diluted	$0.16	$ (0.46)	$0.23	$ (0.43)
Shares on which net income per common shares were based				
Basic	13,803,806	13,803,806	13,803,806	13,803,806
Diluted	13,803,806	13,803,806	13,803,806	13,803,806

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United Security Bancshares and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
(unaudited)

(In thousands except shares)	Common stock Number of Shares	Common stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance January 1, 2011	13,003,849	39,869	33,807	(406)	73,270
Net changes in unrealized loss on available for sale securities (net of income tax expense of $307)				(461)	(461)
Net changes in unrecognized past service Cost on employee benefit plans (net of income tax benefit of $2)				3	3
Common stock dividends	261,335	828	(828)		0
Stock-based compensation expense		10			10
Net Income			(5,993)		(5,993)
Balance June 30, 2011 (As restated)	13,265,184	$ 40,707	$ 26,986	$ (864)	$ 66,829
Net changes in unrealized loss on available for sale securities (net of income tax benefit of $155)				233	233
Net changes in unrecognized past service Cost on employee benefit plans (net of income tax expense of $54)				(78)	(78)
Common stock dividends	266,648	720	(720)		0
Stock-based compensation expense		8			8
Net Loss			(4,819)		(4,819)
Balance December 31, 2011	13,531,832	41,435	21,447	(709)	62,173
Net changes in unrealized loss on available for sale securities (net of income tax expense of $218)				410	410
Common stock dividends	271,974	642	(642)		
Stock-based compensation expense		10			10
Net Income			3,224		3,224
Balance June 30, 2012	13,803,806	42,087	24,029	(299)	65,817

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United Security Bancshares and Subsidiaries
Consolidated Statements of Cash Flows (unaudited)

	Six Months Ended June 30,	
(In thousands)	2012	2011 (As restated)
Cash Flows From Operating Activities:		
Net Income (Loss)	$3,224	$ (5,993)
Adjustments to reconcile net income:to cash provided by operating activities:		
Provision for credit losses	1,006	10,051
Depreciation and amortization	789	907
Accretion of investment securities	(129)	(31)
Decrease in accrued interest receivable	191	112
(Decrease) in accrued interest payable	(16)	(62)
(Increase) Decrease in accounts payable and accrued liabilities	(40)	615
(Decrease) increase in unearned fees	(51)	(224)
Increase (Decrease) in income taxes payable	1,852	(3,539)
Stock-based compensation expense	10	10
Deferred Income Taxes	(332)	0
(Gain) loss on sale of other real estate owned	(337)	44
Impairment loss on other real estate owned	0	1,122
Impairment loss on core deposit intangible	0	36
Impairment loss on investment securities	172	0
Impairment loss on investment in bank stock	69	0
Impairment loss on goodwill	0	1,489
Increase in surrender value of life insurance	(280)	(264)
Loss on fair value option of financial liabilities	112	145
Loss on tax credit limited partnership interest	184	209 418106
Gain on sale of other investment	(1,807)	0
Net decrease in other assets	349	202
Net cash provided by operating activities	4,966	4,829
Cash Flows From Investing Activities:		
Net decrease in interest-bearing deposits with banks	84	2,127
Redemption of correspondent bank stock	293	299
Maturities, calls and principal payments of available-for-sale securities	3,476	8,014
Purchases of available-for-sale securities	0	(6,546)
Net decrease in loans	10,590	3,653
Cash proceeds from sales of other real estate owned	3,532	2,982
Cash proceeds from sale of other investment	2,174	0
Cash proceeds from sale of premises and equipment	36	0
Investment in limited partnership	0	46
Capital expenditures for premises and equipment	(520)	(553)
Net cash provided by investing activities	19,665	10,022
Cash Flows From Financing Activities:		
Net (decrease) increase in demand deposits and savings accounts	(20,686)	30,263
Net decrease in certificates of deposit	(28,739)	(40,170)
Decrease in other borrowings	0	(7,000)
Net cash used in financing activities	(49,425)	(16,907)

Net (decrease) in cash and cash equivalents	(24,794)	(2,056)
Cash and cash equivalents at beginning of period	124,184	98,430
Cash and cash equivalents at end of period	$99,390	$ 96,374

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United Security Bancshares and Subsidiaries - Notes to Consolidated Financial Statements - (Unaudited)

1.Organization and Summary of Significant Accounting and Reporting Policies

The consolidated financial statements include the accounts of United Security Bancshares, and its wholly owned subsidiary United Security Bank (the "Bank") and two bank subsidiaries, USB Investment Trust (the "REIT") and United Security Emerging Capital Fund, (collectively the "Company" or "USB"). Intercompany accounts and transactions have been eliminated in consolidation.

These unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information on a basis consistent with the accounting policies reflected in the audited financial statements of the Company included in its 2011 Annual Report on Form 10-K. These interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of a normal recurring, nature) considered necessary for a fair presentation have been included. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for any other interim period or for the year as a whole.

Certain reclassifications have been made to the 2011 financial statements to conform to the classifications used in 2012. Financial information as of June 30, 2011 is as restated and reported on the Company's form 10Q/A filed with the United States Securities and Exchange Commission (SEC) on November 25, 2011.

New Accounting Standards:

In September 2011, the FASB issued ASU 2011-08, Intangibles - Goodwill and Other (Topic 350) - Testing Goodwill for Impairment. ASU 2011-08 amends Topic 350, Intangibles – Goodwill and Other, to give entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. 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 impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. ASU 2011-08 is effective for annual and interim impairment tests beginning after December 15, 2011, and did not have a significant impact on the Company's financial statements.

In April 2011, the FASB issued ASU No. 2011-02, Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. ASU 2011-02 clarifies the guidance in ASC 310-40 Receivables: Troubled Debt Restructurings by Creditors. Creditors are required to identify a restructuring as a troubled debt restructuring if the restructuring constitutes a concession and the debtor is experiencing financial difficulties. ASU 2011-02 clarifies guidance on whether a creditor has granted a concession and clarifies the guidance on a creditor's evaluation of whether a debtor is experiencing financial difficulties. In addition, ASU 2011-02 also precludes the creditor from using the effective interest rate test in the debtor's guidance on restructuring of payables when evaluating whether a restructuring constitutes a troubled debt restructuring. The effective date of ASU 2011-2 for public entities is effective for the first interim or annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. If, as a result of adoption, an entity identifies newly impaired receivables, an entity should apply the amendments for purposes of measuring impairment prospectively for the first interim or annual period beginning on or after June 15, 2011. The Company adopted the methodologies prescribed by this ASU during the third quarter 2011 and it did not have a material effect on its financial statements.

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In April 2011, the FASB issued ASU 2011-03, Reconsideration of Effective Control for Repurchase Agreements. This ASU was developed to improve the accounting for repurchase agreements (repos) and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The amendments in this ASU remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. The amendments in this ASU apply to all entities, both public and nonpublic. The amendments affect all entities that enter into agreements to transfer financial assets that both entitle and obligate the transferor to repurchase or redeem the financial assets before their maturity. The guidance in this ASU is effective for the first interim or annual period beginning on or after December 15, 2011 and should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. This ASU did not have a significant impact on the Company's financial statements.

In May 2011, the FASB issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The amendments in this ASU result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. This ASU did not have a significant impact on the Company's financial statements.

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income. ASU 2011-05 requires entities to present the total of comprehensive income, the components of net income and the components of other comprehensive income in a single continuous statement of comprehensive income or in two separate consecutive statements. The effective date for ASU 2011-05 is for the first interim or annual period beginning on or after December 15, 2011. The adoption of ASU 2011-05 did not have a material impact on the Company's results of operations or financial position.

2.Investment Securities Available for Sale and Other Investments

Following is a comparison of the amortized cost and fair value of securities available-for-sale, as of June 30, 2012 and December 31, 2011:

(In thousands) June 30, 2012: Securities available for sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
U.S. Government agencies	$ 21,711	$ 1,129	$ (11)	$ 22,829
U.S. Government collateralized mortgage obligations	4,086	326	0	4,412
Residential mortgage obligations	9,595	0	(1,283)	8,312
Total securities available for sale	$ 35,392	$ 1,455	$ (1,294)	$ 35,553
December 31, 2011: Securities available for sale:	Amortized Cost	Unrealized Gains	Unrealized Losses	(Carrying Amount)
U.S. Government agencies	$ 23,680	$ 1,377	$ (7)	$ 25,050
U.S. Government collateralized mortgage obligations	5,010	425	0	5,435
Residential mortgage obligations	10,238	0	(2,265)	7,973
Total securities available for sale	$ 38,928	$ 1,802	$ (2,272)	$ 38,458

The amortized cost and fair value of securities available for sale at June 30, 2012, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties. Contractual maturities on collateralized mortgage obligations cannot be anticipated due to allowed paydowns.

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(In thousands)	June 30, 2012 Amortized Cost	Fair Value (Carrying Amount)
Due in one year or less	$ 5,105	$ 5,140
Due after one year through five years	4,313	4,360
Due after five years through ten years	3,439	3,729
Due after ten years	8,854	9,600
Collateralized mortgage obligations	13,681	12,724
	$ 35,392	$ 35,553

There were no realized gains or losses on sales of available-for-sale securities during the six months ended June 30, 2012 or 2011. There were other-than-temporary impairment losses of $149,000 and $172,000 on certain of the Company's private label mortgage-backed securities for the three and six months ended June 30, 2012, respectively. There were no other-than-temporary impairment losses for the six months ended June 30, 2011.

At June 30, 2012 available-for-sale securities with an amortized cost of approximately $13.4 million (fair value of $14.1 million) were pledged as collateral for FHLB borrowings and public funds balances, respectively.

The Company had no held-to-maturity or trading securities at June 30, 2012 or December 31, 2011.

Management periodically evaluates each available-for-sale investment security in an unrealized loss position to determine if the impairment is temporary or other-than-temporary.

The following summarizes temporarily impaired investment securities:

(In thousands)	Less than 12 Months		12 Months or More		Total	
June 30, 2012: Securities available for sale:	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses
U.S. Government agencies	$ 2,128	$ (11)	$ 0	$ 0	$ 2,128	$ (11)
U.S. Government agency collateral mortgage obligations	0	0	0	0	0	0
Residential mortgage obligations	0	0	8,312	(1,283)	8,312	(1,283)
Total impaired securities	$ 2,128	$ (11)	$ 8,312	$ (1,283)	$ 10,440	$ (1,294)
December 31, 2011: Securities available for sale:						
U.S. Government agencies	$ 2,143	$ (7)	$ 0	$ 0	$ 2,143	$ (7)
U.S. Government agency collateral mortgage obligations	0	0	0	0	0	0

Residential mortgage obligations	0	0	7,994	(2,265)	7,994	(2,265)
Total impaired securities	$ 2,143	$ (7)	$ 7,994	$ (2,265)	$ 10,137	$ (2,272)

The Company evaluates investment securities for other-than-temporary impairment ("OTTI") at least quarterly, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI model. Investment securities classified as available for sale or held-to-maturity are generally evaluated for OTTI under ASC Topic 320, "Investments – Debt and Equity Instruments." Certain purchased beneficial interests, including non-agency mortgage-backed securities, asset-backed securities, and collateralized debt obligations, are evaluated under ASC Topic 325-40 "Beneficial Interest in Securitized Financial Assets.")

In the first segment, the Company considers many factors in determining OTTI, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to the Company at the time of the evaluation.

The second segment of the portfolio uses the OTTI guidance that is specific to purchased beneficial interests including private label mortgage-backed securities. Under this model, the Company compares the present value of the remaining cash flows as estimated at the preceding evaluation date to the current expected remaining cash flows. An OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

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Other-than-temporary-impairment occurs when the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary-impairment shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the other-than-temporary-impairment shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total other-than-temporary-impairment related to the credit loss is recognized in earnings, and is determined based on the difference between the present value of cash flows expected to be collected and the current amortized cost of the security. The amount of the total other-than-temporary-impairment related to other factors shall be recognized in other comprehensive (loss) income, net of applicable taxes. The previous amortized cost basis less the other-than-temporary-impairment recognized in earnings shall become the new amortized cost basis of the investment.

At June 30, 2012, the decline in market value for all but three (see below) of the impaired securities is attributable to changes in interest rates, and not credit quality. Because the Company does not have the intent to sell these impaired securities and it is not more likely than not it will be required to sell the securities before their anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired at June 30, 2012.

At June 30, 2012, the Company had three private label mortgage-backed securities which have been impaired more than twelve months. The three private label mortgage-backed securities had an aggregate fair value of $8.3 million and unrealized losses of approximately $1.3 million at June 30, 2012. All three private label mortgage-backed securities were rated less than high credit quality at June 30, 2012. The Company evaluated these three private label mortgage-backed securities for OTTI by comparing the present value of expected cash flows to previous estimates to determine whether there had been adverse changes in cash flows during the period. The OTTI evaluation was conducted utilizing the services of a third party specialist and consultant in Mortgage Backed Securities (MBS) and Collateralized Mortgage Obligations (CMO) products. The cash flow assumptions used in the evaluation at June 30, 2012 utilized a discounted cash flow valuation technique using a "Liquidation Scenario" whereby loans are evaluated by delinquency and are assigned probability of default and loss factors deemed appropriate in the current economic environment. The liquidation scenarios assume that all loans 60 or more days past due are liquidated and losses are realized over a period of between six and twenty-four months based upon current 3-month trailing loss severities obtained from financial data sources. As a result of the impairment evaluation, the Company determined that there had been adverse changes in cash flows in all three of the private label mortgage-backed securities, and concluded that these three private label mortgage-backed securities were other-than-temporarily impaired. At June 30, 2012, the three private label mortgage-backed securities had cumulative other-than-temporary-impairment losses of $3.6 million, $1.3 million of which was recorded in other comprehensive loss. During the six months ended June 30, 2012, the company recorded OTTI impairment expense of $172,000 on the two private label mortgage-backed securities. During the six months ended June 30, 2011, the company recorded no OTTI impairment expense. These three private label mortgage-backed securities remained classified as available for sale at June 30, 2012.

The following table details the three private label mortgage-backed securities with other-than-temporary-impairment, their credit rating at June 30, 2012, the related credit losses recognized in earnings during the quarter, and impairment losses in other comprehensive loss:

June 30, 2012 (in 000's)	RALI 2006-QS1G A10 Rated D	RALI 2006 QS8 A1 Rated D	CWALT 2007-8CB A9 Rated CCC	Total
Amortized cost – before OTTI	$ 3,719	$ 1,138	$ 7,015	$11,872

Credit loss	(713)	(239)	(1,325)	(2,277)
Other impairment (OCI)	(403)	(122)	(758)	(1,283)
Carrying amount – June 30, 2012	$ 2,603	$ 777	$ 4,932	$ 8,312
Total impairment - June 30, 2012	$ (1,116)	$ (361)	$ (2,083)	$ (3,560)

The total other comprehensive loss (OCI) balance of $1.3 million in the above table is included in unrealized losses of 12 months or more at June 30, 2012.

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The following table summarizes amounts related to credit losses recognized in earnings for the six months and quarters ended June 30, 2012 and 2011.

(in thousands)	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011
Beginning balance - credit losses	2,257	1,795	$ 2,208	$ 1,631
Additions:				
Initial credit impairments	0	0	0	0
Subsequent credit impairments	172	0	149	0
Reductions:				
For securities sold or credit losses realized on principal payments	(152)	(288)	(80)	(124)
Due to change in intent or requirement to sell		0	0	0
For increase expected in cash flows		0	0	0
Ending balance - credit losses	$ 2,277	$ 1,507	$ 2,277	$ 1,507

3.Loans and Leases

Loans are comprised of the following:

(In thousands)	June 30, 2012	December 31, 2011
Commercial and business loans	$ 141,157	$ 163,442
Government program loans	2,500	2,984
Total commercial and industrial	$ 143,657	$ 166,426
Real estate – mortgage:		
Commercial real estate	132,512	118,857
Residential mortgages	25,416	24,031
Home Improvement and Home Equity loans	1,781	1,859
Total real estate mortgage	159,709	144,747
RE construction and development	50,633	50,400
Agricultural	28,957	35,811
Installment	12,095	11,282
Commercial lease financing	30	49
Total Loans	$ 395,081	$ 408,715

The Company's loans are predominantly in the San Joaquin Valley and the greater Oakhurst/East Madera County area, as well as the Campbell area of Santa Clara County, although the Company does participate in loans with other financial institutions, they are primarily in the state of California.

Commercial and industrial loans represent 36.4% of total loans at June 30, 2012 and are generally made to support the ongoing operations of small-to-medium sized commercial businesses. Commercial and industrial loans have a high degree of industry diversification and provide working capital, financing for the purchase of manufacturing plants and equipment, or funding for growth and general expansion of businesses. A substantial portion of commercial and industrial loans are secured by accounts receivable, inventory, leases, or other collateral including real estate. The remainder are unsecured; however, extensions of credit are predicated upon the financial capacity of the borrower. Repayment of commercial loans generally comes from the cash flow of the borrower.

Real estate mortgage loans, representing 40.4% of total loans at June 30, 2012, are secured by trust deeds on primarily commercial property, but are also secured by trust deeds on single family residences. Repayment of real estate mortgage loans generally comes from the cash flow of the borrower.

Commercial real estate mortgage loans comprise the largest segment of this loan category and are available on all types of income producing and commercial properties, including: office buildings and shopping centers; apartments and motels; owner-occupied buildings; manufacturing facilities and more. Commercial real estate mortgage loans can also be used to refinance existing debt. Although real estate associated with the business is the primary collateral for commercial real estate mortgage loans, the underlying real estate is not the source of repayment. Commercial real estate loans are made under the premise that the loan will be repaid from the borrower's business operations, rental income associated with the real property, or personal assets.

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Residential mortgage loans are provided to individuals to finance or refinance single-family residences. Residential mortgages are not a primary business line offered by the Company, and are generally of a shorter term than conventional mortgages, with maturities ranging from three to fifteen years on average.

Home Equity loans comprise a relatively small portion of total real estate mortgage loans, and are offered to borrowers for the purpose of home improvements, although the proceeds may be used for other purposes. Home equity loans are generally secured by junior trust deeds, but may be secured by 1st trust deeds.

Real estate construction and development loans, representing 12.8% of total loans at June 30, 2012, consist of loans for residential and commercial construction projects, as well as land acquisition and development, or land held for future development. Loans in this category are secured by real estate including improved and unimproved land, as well as single-family residential, multi-family residential, and commercial properties in various stages of completion. All real estate loans have established equity requirements. Repayment on construction loans generally comes from long-term mortgages with other lending institutions obtained at completion of the project.

Agricultural loans represent 7.3% of total loans at June 30, 2012 and are generally secured by land, equipment, inventory and receivables. Repayment is from the cash flow of the borrower.

Commercial lease financing loans, representing less than 0.01% of total loans at June 30, 2012, consist of loans to small businesses, which are secured by commercial equipment. Repayment of the lease obligation is from the cash flow of the borrower.

In the normal course of business, the Company is party to financial instruments with off-balance sheet risk to meet the financing needs of its customers. At June 30, 2012 and December 31, 2011, these financial instruments include commitments to extend credit of $61.3 million and $62.4 million, respectively, and standby letters of credit of $2.9 million and $2.5 million, respectively. These instruments involve elements of credit risk in excess of the amount recognized on the balance sheet. The contract amounts of these instruments reflect the extent of the involvement the Company has in off-balance sheet financial instruments.

The Company’s exposure to credit loss in the event of nonperformance by the counterparty to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amounts of those instruments. The Company uses the same credit policies as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer, as long as there is no violation of any condition established in the contract. Substantially all of these commitments are at floating interest rates based on the Prime rate. Commitments generally have fixed expiration dates. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation. Collateral held varies but includes accounts receivable, inventory, leases, property, plant and equipment, residential real estate and income-producing properties.

Standby letters of credit are generally unsecured and are issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

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Past Due Loans

The Company monitors delinquency and potential problem loans on an ongoing basis through weekly reports to the Loan Committee and monthly reports to the Board of Directors. The following is a summary of delinquent loans at June 30, 2012:

June 30, 2012 (000's)	Loans 30-60 Days Past Due	Loans 61-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and Business Loans	$ 1,278	$ 179	$ 531	$ 1,988	$ 139,169	$ 141,157	$ 209
Government Program Loans	638	0	0	638	1,862	2,500	0
Total Commercial and Industrial	1,916	179	531	2,626	141,031	143,657	209
Commercial Real Estate Mortgage Loans	3,243	0	0	3,243	129,269	132,512	0
Residential Mortgage Loans	460	325	0	785	24,631	25,416	0
Home Improvement and Home Equity Loans	89	57	99	245	1,536	1,781	0
Total Real Estate Mortgage	3,792	382	99	4,273	155,436	159,709	0
Total RE Construction and Development Loans	325	0	2,099	2,424	48,209	50,633	0
Total Agricultural Loans	546	0	0	546	28,411	28,957	0
Consumer Loans	539	0	0	539	11,342	11,881	0
Overdraft protection Lines	0	0	0	0	0	0	0
Overdrafts	0	0	0	0	214	214	0
Total Installment/other	539	0	0	539	11,556	12,095	0
Commercial Lease Financing	0	0	0	0	30	30	0

Total Loans	$ 7,118	$ 561	$ 2,729	$ 10,408	$ 384,673	$ 395,081	$ 209

The following is a summary of delinquent loans at December 31, 2011:

December 31, 2011 (000's)	Loans 30-60 Days Past Due	Loans 61-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and Business Loans	$ 154	$ 191	$ 3,552	$ 3,897	$ 159,545	$ 163,442	$ 0
Government Program Loans	0	0	433	433	2,551	2,984	74
Total Commercial and Industrial	154	191	3,985	4,330	162,096	166,426	74
Commercial Real Estate Loans	1,248	2,514	0	3,762	115,095	118,857	0
Residential Mortgages	328	0	0	328	23,703	24,031	0
Home Improvement and Home Equity Loans	62	132	0	194	1,665	1,859	0
Total Real Estate Mortgage	1,638	2,646	0	4,284	140,463	144,747	0
Total RE Construction and Development Loans	0	0	6,150	6,150	44,250	50,400	0
Total Agricultural Loans	0	0	0	0	35,811	35,811	0
Consumer Loans	297	0	0	297	10,776	11,073	0
Overdraft protection Lines	0	0	0	0	85	85	0
Overdrafts	0	0	0	0	124	124	0
Total Installment	297	0	0	297	10,985	11,282	0
Commercial Lease Financing	0	0	0	0	49	49	0
Total Loans	$ 2,089	$ 2,837	$ 10,135	$ 15,061	$ 393,654	$ 408,715	$ 74

Nonaccrual Loans

Commercial, construction and commercial real estate loans are placed on non-accrual status under the following circumstances:

-When there is doubt regarding the full repayment of interest and principal.

-When principal and/or interest on the loan has been in default for a period of 90-days or more, unless the asset is both well secured and in the process of collection that will result in repayment in the near future.

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-When the loan is identified as having loss elements and/or is risk rated "8" Doubtful.

-Other circumstances which jeopardize the ultimate collectability of the loan including certain troubled debt restructurings, identified loan impairment, and certain loans to facilitate the sale of OREO.

Loans meeting any of the preceding criteria are placed on non-accrual status and the accrual of interest for financial statement purposes is discontinued. Previously accrued but unpaid interest is reversed and charged against interest income.

Loans that are secured by one-to-four family residential properties (e.g., residential mortgage loans and home equity loans) on which principal and/or interest is due and unpaid for 90 days or more are placed on non-accrual and the accrual of interest for financial statement purposes is discontinued. Previously accrued but unpaid interest is reversed and charged against interest income.

Consumer loans to individuals for personal, family and household purposes, and unsecured or secured personal property where principal or interest is due and unpaid for 90 days or more are placed on non-accrual and the accrual of interest for financial statement purposes is discontinued. Previously accrued but unpaid interest is reversed and charged against interest income.

When a loan is placed on non-accrual status and subsequent payments of interest (and principal) are received, the interest received may be accounted for in two separate ways:

Cost recovery method: If the loan is in doubt as to full collection, the interest received in subsequent payments is diverted from interest income to a valuation reserve and treated as a reduction of principal for financial reporting purposes.

Cash basis: This method is only used if the recorded investment or total contractual amount is expected to be fully collectible, under which circumstances the subsequent payments of interest is credited to interest income as received.

Loans on non-accrual status are usually not returned to accrual status unless all delinquent principal and/or interest has been brought current, there is no identified element of loss, and current and continued satisfactory performance is expected (loss of the contractual amount not the carrying amount of the loan). Repayment ability is generally demonstrated through the timely receipt of at least six monthly payments on a loan with monthly amortization.

Nonaccrual loans totaled $18.2 million and $18.1 million at June 30, 2012 and December 31, 2011, respectively. There were no remaining undisbursed commitments to extend credit on nonaccrual loans at June 30, 2012 or December 31, 2011.
The following is a summary of nonaccrual loan balances at June 30, 2012 and December 31, 2011.

	June 30, 2012	December 31, 2011
Commercial and Business Loans	$ 8,385	$ 4,722
Government Program Loans	107	358
Total Commercial and Industrial	8,492	5,080
Commercial Real Estate Loans	3,771	3,946
Residential Mortgages	37	43
Home Improvement and Home Equity Loans	111	0

Total Real Estate Mortgage	3,919	3,989
Total RE Construction and Development Loans	4,679	9,014
Total Agricultural Loans	661	0
Consumer Loans	438	15
Overdraft protection Lines	0	0
Overdrafts	0	0
Total Installment	438	15
Commercial lease Financing	0	0
Total Loans	$ 18,189	$ 18,098

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Impaired Loans

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 loan agreement.

The Company applies its normal loan review procedures in making judgments regarding probable losses and loan impairment. The Company evaluates for impairment those loans on non-accrual status, graded doubtful, graded substandard or those that are troubled debt restructures. The primary basis for inclusion in impaired status under generally accepted accounting pronouncements is that it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement.

A loan is not considered impaired if:

- There is merely an insignificant delay or shortfall in the amounts of payments.
- The Company expects to collect all amounts due, including interest accrued, at the contractual interest rate for the period of the delay.

Review for impairment does not include large groups of smaller balance homogeneous loans that are collectively evaluated to estimate the allowance for loan losses. The Company's present allowance for loan losses methodology, including migration analysis, captures required reserves for these loans in the formula allowance.

For loans determined to be impaired, the Company evaluates impairment based upon either the fair value of underlying collateral, discounted cash flows of expected payments, or observable market price.

- For loans secured by collateral including real estate and equipment the fair value of the collateral less selling costs will determine the carrying value of the loan. The difference between the recorded investment in the loan and the fair value, less selling costs, determines the amount of impairment. The Company uses the measurement method based on fair value of collateral when the loan is collateral dependent and foreclosure is probable.

- The discounted cash flow method of measuring the impairment of a loan is used for unsecured loans or for loans secured by collateral where the fair value cannot be easily determined. Under this method, the Company assesses both the amount and timing of cash flows expected from impaired loans. The estimated cash flows are discounted using the loan's effective interest rate. The difference between the amount of the loan on the Bank's books and the discounted cash flow amounts determines the amount of impairment to be provided. This method is used for most of the Company's troubled debt restructurings or other impaired loans where some payment stream is being collected.

- The observable market price method of measuring the impairment of a loan is only used by the Company when the sale of loans or a loan is in process.

The method for recognizing interest income on impaired loans is dependent on whether the loan is on nonaccrual status or is a troubled debt restructuring. For income recognition, the existing nonaccrual and troubled debt restructuring policies are applied to impaired loans. Generally, except for certain troubled debt restructurings which are performing under the restructure agreement, the Company does not recognize interest income received on impaired loans, but reduces the carrying amount of the loan for financial reporting purposes.

Loans other than certain homogenous loan portfolios are reviewed on a quarterly basis for impairment. Impaired loans are written down to estimated realizable values by the establishment of specific reserves or charge-offs when required.

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The following is a summary of impaired loans at June 30, 2012.

June 30, 2012 (000's)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
Commercial and Business Loans	$ 9,929	$ 7,559	$ 2,240	$ 9,799	$ 166	$ 7,586
Government Program Loans	465	107	0	107	0	181
Total Commercial and Industrial	10,394	7,666	2,240	9,906	166	7,767
Commercial Real Estate Term Loans	7,971	2,780	4,922	7,702	517	7,937
Single Family Residential Loans	3,863	654	3,172	3,826	153	3,623
Home Improvement and Home Equity Loans	12	12	0	12	0	$ 28
Total Real Estate Mortgage	11,846	3,446	8,094	11,540	670	11,588
Total RE Construction and Development Loans	6,253	6,148	0	6,148	0	9,700
Total Agricultural Loans	999	719	0	719	0	1,524
Consumer Loans	92	89	0	89	0	127
Overdraft protection Lines	0	0	0	0	0	$ 0
Overdrafts	0	0	0	0	0	$ 0
Total Installment/other	92	89	0	89	0	127
Commercial Lease Financing	0	0	0	0	0	0
Total Impaired Loans	$ 29,584	$ 18,068	$ 10,334	$ 28,402	$ 836	$ 30,706

The following is a summary of impaired loans at December 31, 2011.

December 31, 2011 (000's)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
Commercial and Business Loans	$ 6,521	$ 4,002	$ 2,425	$ 6,427	$ 112	$ 11,102
Government Program Loans	704	212	0	212	0	301
	7,225	4,214	2,425	6,639	112	11,403

Total Commercial and Industrial						
Commercial Real Estate Loans	8,457	4,209	4,094	8,303	523	7,258
Residential Mortgages	3,569	494	3,037	3,531	166	3,619
Home Improvement and Home Equity Loans	36	22	15	37	1	96
Total Real Estate Mortgage	12,062	4,725	7,146	11,871	690	10,973
Total RE Construction and Development Loans	11,535	9,014	2,418	11,432	71	17,184
Total Agricultural Loans	2,445	61	1,792	1,853	381	2,139
Consumer Loans	88	87	0	87	0	184
Overdraft protection Lines	0	0	0	0	0	0
Overdrafts	0	0	0	0	0	0
Total Installment	88	87	0	87	0	184
Commercial Lease Financing	0	0	0	0	0	55
Total Impaired Loans	$ 33,355	$ 18,101	$ 13,781	$ 31,882	$ 1,254	$ 41,938

In most cases, the Company uses the cash basis method of income recognition for impaired loans. In the case of certain troubled debt restructurings for which the loan is performing under the current contractual terms for a reasonable period of time, income is recognized under the accrual method.

The average recorded investment in impaired loans for the quarter ended June 30, 2011 and June 2012 was $45.9 million and $30.1 million, while the average recorded investment in impaired loans for the six months ended June 30, 2011 and June 2012 was $47.6 million and $30.7 million, respectively.

Interest income recognized on impaired loans for the quarters ended June 30, 2012 and 2011 was approximately $127,000 and $156, respectively. Interest income recognized on impaired loans during the six months ended June 30, 2012 and 2011 was approximately $253,000 and $312,000, respectively.

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Troubled Debt Restructurings

Under the circumstances, when the Company grants a concession to a borrower as part of a loan restructuring, the restructuring is accounted for as a troubled debt restructuring (TDR). TDRs are reported as a component of impaired loans.

A TDR is a type of restructuring in which the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession (either imposed by court order, law, or agreement between the borrower and the Bank) to the borrower that it would not otherwise consider. Although the restructuring may take different forms, the Company's objective is to maximize recovery of its investment by granting relief to the borrower.

A TDR may include, but is not limited to, one or more of the following:

- A transfer from the borrower to the Company of receivables from third parties, real estate, other assets, or an equity interest in the borrower is granted to fully or partially satisfy the loan.
- A modification of terms of a debt such as one or a combination of:
  - o The reduction (absolute or contingent) of the stated interest rate.
  - o The extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk.
  - o The reduction (absolute or contingent) of the face amount or maturity amount of the debt as stated in the instrument or agreement.
  - o The reduction (absolute or contingent) of accrued interest.

For a restructured loan to return to accrual status there needs to be, among other factors, at least 6 months successful payment history. In addition, the Company performs a financial analysis of the credit to determine whether the borrower has the ability to continue to meet payments over the remaining life of the loan. This includes, but is not limited to, a review of financial statements and cash flow analysis of the borrower. Only after determination that the borrower has the ability to perform under the terms of the loans, will the restructured credit be considered for accrual status.

The following table illustrates TDR activity for the periods indicated:

	Six Months Ended June 30, 2012		
Troubled Debt Restructurings	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and Business Loans	0	$ 0	$ 0
Government Program Loans	0	0	0

Commercial Real Estate Term Loans	5	1,330	1,321
Single Family Residential Loans	0	0	0
Home Improvement and Home Equity Loans	0	0	0
RE Construction and Development Loans	0	0	0
Agricultural Loans	0	0	0
Consumer Loans	0	0	0
Overdraft protection Lines	0	0	0
Commercial Lease Financing	0	0	0
Total Loans	5	$ 1,330	$ 1,321

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Troubled Debt Restructurings that Defaulted	Six Months Ended June 30, 2012 Number of Contracts	Recorded Investment
Commercial and Business Loans	0	$ 0
Government Program Loans	0	0
Commercial Real Estate Term Loans	0	0
Single Family Residential Loans	0	0
Home Improvement and Home Equity Loans	0	0
RE Construction and Development Loans	0	0
Agricultural Loans	0	0
Consumer Loans	0	0
Overdraft protection Lines	0	0
Commercial Lease Financing	0	0
Total Loans	0	$ 0

Troubled Debt Restructurings	Three Months Ended June 30, 2012		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and Business Loans	0	$ 0	$ 0
Government Program Loans	0	0	0
Commercial Real Estate Term Loans	1	20	20
Single Family Residential Loans	0	0	0
Home Improvement and Home Equity Loans	0	0	0
RE Construction and Development Loans	0	0	0
Agricultural Loans	0	0	0
Consumer Loans	0	0	0
Overdraft protection Lines	0	0	0
Commercial Lease Financing	0	0	0
Total Loans	1	$ 20	$ 20

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Troubled Debt Restructurings that Defaulted	Three Months Ended June 30, 2012 Number of Contracts	Recorded Investment
Commercial and Business Loans	0	$ 0
Government Program Loans	0	0
Commercial Real Estate Term Loans	0	0
Single Family Residential Loans	0	0
Home Improvement and Home Equity Loans	0	0
RE Construction and Development Loans	0	0
Agricultural Loans	0	0
Consumer Loans	0	0
Overdraft protection Lines	0	0
Commercial Lease Financing	0	0
Total Loans	0	$ 0

The Company makes various types of concessions when structuring TDRs including rate reductions, payment extensions, and forbearance. At June 30, 2012, the Company had 42 restructured loans totaling $16.8 million as compared to 41 restructured loans totaling $19.0 million at December 31, 2011.

Credit Quality Indicators

As part of its credit monitoring program, the Company utilizes a risk rating system which quantifies the risk the Company estimates it has assumed during the life of a loan. The system rates the strength of the borrower and the facility or transaction, and is designed to provide a program for risk management and early detection of problems.

For each new credit approval, credit extension, renewal, or modification of existing credit facilities, the Company assigns risk ratings utilizing the rating scale identified in this policy. In addition, on an on-going basis, loans and credit facilities are reviewed for internal and external influences impacting the credit facility that would warrant a change in the risk rating. Each loan credit facility is to be given a risk rating that takes into account factors that materially affect credit quality.

When assigning risk ratings, the Company evaluates two risk rating approaches, a facility rating and a borrower rating as follows:

Facility Rating:

The facility rating is determined by the analysis of positive and negative factors that may indicate that the quality of a particular loan or credit arrangement requires that it be rated differently from the risk rating assigned to the borrower. The Company assesses the risk impact of these factors:

Collateral - The rating may be affected by the type and quality of the collateral, the degree of coverage, the economic life of the collateral, liquidation value and the Company's ability to dispose of the collateral.

Guarantees - The value of third party support arrangements varies widely. Unconditional guaranties from persons with demonstrable ability to perform are more substantial than that of closely related persons to the borrower who offer only modest support.

Unusual Terms - Credit may be extended on terms that subject the Company to a higher level of risk than indicated in the rating of the borrower.

Borrower Rating:

The borrower rating is a measure of loss possibility based on the historical, current and anticipated financial characteristics of the borrower in the current risk environment. To determine the rating, the Company considers at least the following factors:

-Quality of management
-Liquidity
-Leverage/capitalization
-Profit margins/earnings trend
-Adequacy of financial records
-Alternative funding sources

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-Geographic risk
-Industry risk
-Cash flow risk
-Accounting practices
-Asset protection
-Extraordinary risks

The Company assigns risk ratings to loans other than consumer loans and other homogeneous loan pools based on the following scale. The risk ratings are used when determining borrower ratings as well as facility ratings. When the borrower rating and the facility ratings differ, the lowest rating applied is:

-Grades 1 and 2 – These grades include loans which are given to high quality borrowers with high credit quality and sound financial strength. Key financial ratios are generally above industry averages and the borrower's strong earnings history or net worth. These may be secured by deposit accounts or high-grade investment securities.

-Grade 3 – This grade includes loans to borrowers with solid credit quality with minimal risk. The borrower's balance sheet and financial ratios are generally in line with industry averages, and the borrower has historically demonstrated the ability to manage economic adversity. Real estate and asset-based loans assigned this risk rating must have characteristics, which place them well above the minimum underwriting requirements for those departments. Asset-based borrowers assigned this rating must exhibit extremely favorable leverage and cash flow characteristics, and consistently demonstrate a high level of unused borrowing capacity.

-Grades 4 and 5 – These include "pass" grade loans to borrowers of acceptable credit quality and risk. The borrower's balance sheet and financial ratios may be below industry averages, but above the lowest industry quartile. Leverage is above and liquidity is below industry averages. Inadequacies evident in financial performance and/or management sufficiency are offset by readily available features of support, such as adequate collateral, or good guarantors having the liquid assets and/or cash flow capacity to repay the debt. The borrower may have recognized a loss over three or four years, however recent earnings trends, while perhaps somewhat cyclical, are improving and cash flows are adequate to cover debt service and fixed obligations. Real estate and asset-borrowers fully comply with all underwriting standards and are performing according to projections would be assigned this rating. These also include grade 5 loans which are "leveraged" or on management's "watch list." While still considered pass loans (loans given a grade 5), the borrower's financial condition, cash flow or operations evidence more than average risk and short term weaknesses , these loans warrant a higher than average level of monitoring, supervision and attention from the Company, but do not reflect credit weakness trends that weaken or inadequately protect the Company's credit position. Loans with a grade rating of 5 are not normally acceptable as new credits unless they are adequately secured or carry substantial endorser/guarantors.

-Grade 6 – This grade includes "special mention" loans which are loans that are currently protected but are potentially weak. This generally is an interim grade classification and should usually be upgraded to an Acceptable rating or downgraded to Substandard within a reasonable time period. Weaknesses in special mention loans may, if not checked or corrected, weaken the asset or inadequately protect the Company's credit position at some future date. Special mention loans are often loans with weaknesses inherent from the loan origination, loan servicing, and perhaps some technical deficiencies. The main theme in special mention credits is the distinct probability that the classification will deteriorate to a more adverse class if the noted deficiencies are not addressed by the loan officer or loan management.

-Grade 7 – This grade includes "substandard" loans which are inadequately supported by the current sound net worth and paying capacity of the borrower or of the collateral pledged, if any. Substandard loans have a well-defined weakness or weaknesses that may impair the regular liquidation of the debt. Substandard loans exhibit a distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Substandard loans also include impaired loans.

- Grade 8 - This grade includes "doubtful" loans which exhibit the same characteristics as the Substandard loans with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing 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 loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include a proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans.

- Grade 9 - This grade includes loans classified "loss" which are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off the asset even though partial recovery may be achieved in the future.

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The Company did not carry any loans graded as loss at June 30, 2012 or December 31, 2011.

The following tables summarize the credit risk ratings for commercial, construction, and other non-consumer related loans for June 30, 2012 and December 31, 2011:

June 30, 2012 (000's)	Commercial and Lease Financing	Commercial RE	RE Construction and Development	Agricultural	Total
Grades 1and 2	$ 456	$ 0	$ 0	$ 0	$ 456
Grade 3	1,656	6,895	876	0	9,427
Grades 4 and 5 – pass	122,358	118,276	32,899	28,296	301,829
Grade 6 – special mention	10,452	919	0	0	11,371
Grade 7 – substandard	8,765	6,422	16,858	661	32,706
Grade 8 – doubtful	0	0	0	0	0
Total	$ 143,687	$ 132,512	$ 50,633	$ 28,957	$ 355,789

December 31, 2011 (000's)	Commercial and Lease Financing	Commercial RE	RE Construction and Development	Agricultural	Total
Grades 1and 2	$ 725	$ 0	$ 0	$ 40	$ 765
Grade 3	184	7,026	897	0	8,107
Grades 4 and 5 – pass	149,815	104,468	28,596	33,990	316,869
Grade 6 – special mention	10,431	749	0	0	11,180
Grade 7 – substandard	5,320	6,614	20,907	1,781	34,622
Grade 8 – doubtful					
Total	$ 166,475	$ 118,857	$ 50,400	$ 35,811	$ 371,543

The Company follows consistent underwriting standards outlined in its loan policy for consumer and other homogenous loans but, does not specifically assign a risk rating when these loans are originated. Consumer loans are monitored for credit risk and are considered “pass” loans until some issue or event requires that the credit be downgraded to special mention or worse.

The following tables summarize the credit risk ratings for consumer related loans and other homogenous loans for June 30, 2012 and December 31, 2011:

	June 30, 2012				December 31, 2011			
(000's)	Single family Residential	Home Improvement and Home Equity	Installment	Total	Single family Residential	Home Improvement and Home Equity	Installment	Total
Not graded	$ 19,690	$ 1,748	$ 9,771	$ 31,209	$ 18,858	$ 1,801	$ 9,615	$ 30,274
Pass	5,358	21	1,779	7,158	4,796	22	1,163	5,981
Special Mention	0	0	47	47	0	0	423	423

Substandard	368	12	498	878	377	36	81	494
Total	$ 25,416	$ 1,781	$ 12,095	$ 39,292	$ 24,031	$ 1,859	$ 11,282	$ 37,172

Allowance for Loan Losses

The Company analyzes risk characteristics inherent in each loan portfolio segment as part of the quarterly review of the adequacy of the allowance for loan losses. The following summarizes some of the key risk characteristics for the eleven segments of the loan portfolio (Consumer loans include three segments):

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Commercial and business loans – Commercial loans are subject to the effects of economic cycles and tend to exhibit increased risk as economic conditions deteriorate, or if the economic downturn is prolonged. The Company considers this segment to be one of higher risk given the size of individual loans and the balances in the overall portfolio.

Government program loans – This is a relatively a small part of the Company's loan portfolio, but has historically had a high percentage of loans that have migrated from pass to substandard given there vulnerability to economic cycles.

Commercial real estate loans – This segment is considered to have more risk in part because of the vulnerability of commercial businesses to economic cycles as well as the exposure to fluctuations in real estate prices because most of these loans are secured by real estate. Losses in this segment have however been historically low because most of the loans are real estate secured.

Single family residential loans – This segment is considered to have low risk factors both from the Company and peer statistics. These loans are secured by first deeds of trust. The losses experienced over the past twelve quarters are isolated to approximately seven loans and are generally the result of short sales.

Home improvement and home equity loans – Because of their junior lien position, these loans have an inherently higher risk level. Because residential real estate has been severely distressed in the recent past, the anticipated risk for this loan segment has increased.

Real estate construction loans –In a normal economy, this segment of loans is considered to have a higher risk profile due to construction and market value issues in conjunction with normal credit risks. In the current distressed residential real estate markets the risk has increased.

Agricultural loans – This segment is considered to have risks associated with weather, insects, and marketing issues. In addition, concentrations in certain crops or certain agricultural areas can increase risk.

Consumer loans (includes consumer loans, overdrafts, and overdraft protection lines) – This segment is higher risk because many of the loans are unsecured.

Commercial lease financing – This segment of the portfolio is small, but is considered to be vulnerable to economic cycles given the nature of the leasing relationship where businesses are relatively small or have minimal cash flow. This lending program was terminated in 2005.

The following summarizes the activity in the allowance for credit losses by loan category for the six and three months ended June 30, 2012.

Six Months Ended June 30, 2012 (in 000's)	Commercial and Industrial	Real Estate Mortgage	RE Construction Development	Agricultural	Installment & Other	Commercial Lease Financing	Unallocated	Total
Beginning balance	$ 6,787	$ 1,416	$ 4,579	$ 508	$ 116	$ 1	$ 241	$ 13,648
Provision for credit losses	(2,521)	(313)	1,231	1,938	344	2	325	1,006
Charge-offs	(763)	(53)	(10)	(2,169)	(137)	0	0	(3,132)
Recoveries	61	4	0	0	23	0	0	88

Net charge-offs	(702)	(49)	(10)	(2,169)	(114)	0	0	(3,044)
Ending balance	$ 3,564	$ 1,054	$ 5,800	$ 277	$ 346	$ 3	$ 566	$ 11,610
Period-end amount allocated to:								
Loans individually evaluated for impairment	$ 166	$ 670	$ 0	$ 0	$ 0	$ 0	$ 0	$ 836
Loans collectively evaluated for impairment	3,398	384	5,800	277	346	3	566	10,774
Ending balance	$ 3,564	$ 1,054	$ 5,800	$ 277	$ 346	$ 3	$ 566	$ 11,610

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Three Months Ended June 30, 2012 (in 000's)	Commercial and Industrial	Real Estate Mortgage	RE Construction Development	Agricultural	Installment & Other	Commercial Lease Financing	Unallocated	Total
Beginning balance	$ 5,220	$ 1,472	$ 4,523	$ 1,116	$ 87	$ 1	$ 631	$ 13,050
Provision for credit losses	(1,533)	(401)	1,287	1,330	384	2	(65)	1,004
Charge-offs	(146)	(20)	(10)	(2,169)	(135)	0	0	(2,480)
Recoveries	23	3	0	0	10	0	0	36
Net charge-offs	(123)	(17)	(10)	(2,169)	(125)	0	0	(2,444)
Ending balance	$ 3,564	$ 1,054	$ 5,800	$ 277	$ 346	$ 3	$ 566	$ 11,610
Period-end amount allocated to:								
Loans individually evaluated for impairment	$ 166	$ 670	$ 0	$ 0	$ 0	$ 0	$ 0	$ 836
Loans collectively evaluated for impairment	3,398	384	5,800	277	346	3	566	10,774
Ending balance	$ 3,564	$ 1,054	$ 5,800	$ 277	$ 346	$ 3	$ 566	$ 11,610

The following summarizes the activity in the allowance for credit losses by loan category for the six and three months ended June 30, 2011.

Six Months Ended June 30, 2011 (in 000's) (As Restated)	Commercial and Industrial	Real Estate Mortgage	RE Construction Development	Agricultural	Installment & Other	Commercial Lease Financing	Unallocated	Total
Beginning balance	$ 8,209	$ 1,620	$ 5,763	$ 850	$ 49	$ 3	$ 26	$ 16,520
Provision for credit losses	5,791	281	3,966	(100)	36	103	(26)	10,051
Charge-offs	(6,897)	(406)	(5,480)	(537)	(20)	(100)		(13,440)
Recoveries	72	0	607	66	3	0		748
Net charge-offs	(6,825)	(406)	(4,873)	(471)	(17)	(100)	0	(12,692)

Ending balance	$ 7,175	$ 1,495	$ 4,856	$ 279	$ 68	$ 6	$ 0	$ 13,879
Period-end amount allocated to:								
Loans individually evaluated for impairment	$ 652	$ 467	$ 978	$ 149	$ 23	$ 0	$ 0	$ 2,269
Loans collectively evaluated for impairment	6,523	1,028	3,878	130	45	6	0	11,610
Ending balance	$ 7,175	$ 1,495	$ 4,856	$ 279	$ 68	$ 6	$ 0	$ 13,879

Three Months Ended June 30, 2011 (in 000's) (As Restated)	Commercial and Industrial	Real Estate Mortgage	RE Construction Development	Agricultural	Installment & Other	Commercial Lease Financing	Unallocated	Total
Beginning balance	8,337	$ 1,574	$ 6,059	$ 381	$ 80	$ 24	$ 290	$ 16,745
Provision for credit losses	5,621	300	3,668	(147)	5	4	(290)	9,161
Charge-offs	(6,826)	(379)	(5,478)	(1)	(18)	(22)	0	(12,724)
Recoveries	43	0	607	46	1	0	0	697
Net charge-offs	(6,783)	(379)	(4,871)	45	(17)	(22)	0	(12,027)
Ending balance	$ 7,175	$ 1,495	$ 4,856	$ 279	$ 68	$ 6	$ 0	$ 13,879
Period-end amount allocated to:								
Loans individually evaluated for impairment	$ 652	$ 467	$ 978	$ 149	$ 23	$ 0	$ 0	$ 2,269
Loans collectively evaluated for impairment	6,523	1,028	3,878	130	45	6	0	11,610
Ending balance	$ 7,175	$ 1,495	$ 4,856	$ 279	$ 68	$ 6	$ 0	$ 13,879

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The following summarizes information with respect to the loan balances at June 30, 2012 and December 31, 2011.

	June 30, 2012			December 31, 2011		
(000's)	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Total Loans	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Total Loans
Commercial and Business Loans	$ 9,799	$ 131,358	$ 141,157	$ 6,427	$ 157,015	$ 163,442
Government Program Loans	107	$ 2,393	2,500	212	2,772	2,984
Total Commercial and Industrial	9,906	$ 133,751	143,657	6,639	159,787	166,426
Commercial Real Estate Loans	7,702	$ 124,810	132,512	8,303	110,554	118,857
Residential Mortgage Loans	3,826	$ 21,590	25,416	3,531	20,500	24,031
Home Improvement and Home Equity Loans	12	$ 1,769	1,781	37	1822	1,859
Total Real Estate Mortgage	11,540	$ 148,169	159,709	11,871	132,876	144,747
Total RE Construction and Development Loans	6,148	$ 44,485	50,633	11,432	38,968	50,400
Total Agricultural Loans	719	$ 28,238	28,957	1,853	33,958	35,811
Total Installment Loans	89	$ 12,006	12,095	87	11,195	11,282
Commercial Lease Financing	0	$ 30	30	0	49	49
Total Loans	$ 28,402	$ 366,679	$ 395,081	$ 31,882	$ 376,833	$ 408,715

4.Deposits

Deposits include the following:

(In thousands)	June 30, 2012	December 31, 2011
Noninterest-bearing deposits	$ 197,052	$ 224,907
Interest-bearing deposits:		

NOW and money market accounts		173,163		165,937
Savings accounts		40,041		40,099
Time deposits:				
Under $100,000		38,417		53,271
$100,000 and over		76,329		90,213
Total interest-bearing deposits		327,950		349,520
Total deposits	$	525,002	$	574,427
Total brokered deposits included in time deposits above	$	30,457	$	49,261

5.Short-term Borrowings/Other Borrowings

At June 30, 2012, the Company had collateralized lines of credit with the Federal Reserve Bank of San Francisco totaling $228.3 million, as well as Federal Home Loan Bank (FHLB) lines of credit totaling $13.4 million. All lines of credit are on an "as available" basis and can be revoked by the grantor at any time. There are currently no restrictions on these lines of credit, although under the current Written Agreement with the Federal Reserve, the Bank's liquidity position as well as its use of borrowing lines is monitored closely. These lines of credit have interest rates that are generally tied to the Federal Funds rate or are indexed to short-term U.S. Treasury rates or LIBOR. FHLB lines of credit are collateralized by investment securities, while lines of credit with the Federal Reserve Bank are collateralized by certain qualifying loans. As of June 30, 2012, $13.4 million in investment securities at FHLB were pledged as collateral for FHLB advances. Additionally, $326.1 million in qualifying loans were pledged at June 30, 2012 as collateral for borrowing lines with the Federal Reserve Bank. At June 30, 2012, the Company had no outstanding borrowings.

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At December 31, 2011, the Company had collateralized and uncollateralized lines of credit with the Federal Reserve Bank of San Francisco and other correspondent banks aggregating $250.1 million, as well as Federal Home Loan Bank ("FHLB") lines of credit totaling $17.6 million. At December 31, 2011, the Company had no outstanding borrowing balances. The weighted average cost of borrowings for the year ended December 31, 2011 was 0.73%. These lines of credit generally have interest rates tied to the Federal Funds rate or are indexed to short-term U.S. Treasury rates or LIBOR. FHLB advances are collateralized by all of the Company's stock in the FHLB, investment securities, and certain qualifying mortgage loans. As of December 31, 2011, $18.5 million in investment securities at FHLB were pledged as collateral for FHLB advances. Additionally, $346.9 million in real estate-secured loans were pledged at December 31, 2011, as collateral for used and unused borrowing lines with the Federal Reserve Bank totaling $232.5 million. All lines of credit are on an "as available" basis and can be revoked by the grantor at any time.

6.Supplemental Cash Flow Disclosures

	Six Months Ended June 30,	
(In thousands)	2012	2011
Cash paid during the period for:		
Interest	$ 1,067	$ 1,666
Income Taxes	$ 0	$ 1,180
Noncash investing activities:		
Loans transferred to foreclosed assets	$ 0	$ 1,506

7.Common Stock Dividend

On June 26, 2012, the Company's Board of Directors declared a one-percent (1%) stock dividend on the Company's outstanding common stock. Based upon the number of outstanding common shares on the record date of July 13, 2012, 136,654 additional shares were issued to shareholders on July 25, 2012. Because the stock dividend was considered a "small stock dividend," approximately $309,000 was transferred from retained earnings to common stock based upon the $2.47 closing price of the Company's common stock on the declaration date of June 26, 2011. There were no fractional shares paid. Except for earnings-per-share calculations, shares issued for the stock dividend have been treated prospectively for financial reporting purposes. For purposes of earnings per share calculations, the Company's weighted average shares outstanding and potentially dilutive shares used in the computation of earnings per share have been restated after giving retroactive effect to a 1% stock dividend to shareholders for all periods presented.

8.Net (Loss) Income per Common Share

The following table provides a reconciliation of the numerator and the denominator of the basic EPS computation with the numerator and the denominator of the diluted EPS computation:

	Quarter Ended June 30,		Six months Ended June 30,	
(In thousands except earnings per share data)	2012	2011 (As restated)	2012	2011 (As restated)
Net income available to common shareholders	$2,172	$ (6,349)	3,224	$ (5,993)
Weighted average shares issued	13,803,806	13,803,806	13,803,806	13,803,806
Add: dilutive effect of stock options	0	0	0	0
Weighted average shares outstanding adjusted for potential dilution	13,803,806	13,803,806	13,803,806	13,803,806

Basic earnings per share	$0.16	$ (0.46)	$0.23	$ (0.43)
Diluted earnings per share	$0.16	$ (0.46)	$0.23	$ (0.43)
Anti-dilutive stock options excluded from earnings per share calculation	158	224	158	224

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9.Taxes on Income

The Company periodically reviews its tax positions under the accounting standards related to uncertainty in income taxes, which defines the criteria that an individual tax position would have to meet for some or all of the income tax benefit to be recognized in a taxable entity's financial statements. Under the guidelines, an entity should recognize the financial statement benefit of a tax position if it determines that it is more likely than not that the position will be sustained on examination. The term "more likely than not" means a likelihood of more than 50 percent. In assessing whether the more-likely-than-not criterion is met, the entity should assume that the tax position will be reviewed by the applicable taxing authority and all available information is known to the taxing authority. The Company periodically evaluates its deferred tax assets to determine whether a valuation allowance is required based upon a determination that some or all of the deferred assets may not be ultimately realized. At June 30, 2012 and December 31, 2011, the Company had a recorded valuation allowance of $3.7 million.

The Company and its subsidiary file income tax returns in the U.S federal jurisdiction, and several states within the U.S. There are no filings in foreign jurisdictions. The Company is not currently aware of any tax jurisdictions where the Company or any subsidiary is subject to examination by federal, state, or local taxing authorities before 2001. The Internal Revenue Service (IRS) has not examined the Company's or any subsidiaries federal tax returns since before 2001. The Company currently is subject to a limited scope audit by the IRS which began during the third quarter of 2011 related to the Company's amendment of its 2009 federal tax return to utilize the five-year carry-back provisions allowed for losses realized during the 2009 tax year.

10. Junior Subordinated Debt/Trust Preferred Securities

Effective September 30, 2009 and beginning with the quarterly interest payment due October 1, 2009, the Company elected to defer interest payments on the Company's $15.0 million of junior subordinated debentures relating to its trust preferred securities. The terms of the debentures and trust indentures allow for the Company to defer interest payments for up to 20 consecutive quarters without default or penalty. During the period that the interest deferrals are elected, the Company will continue to record interest expense associated with the debentures. Upon the expiration of the deferral period, all accrued and unpaid interest will be due and payable. During the deferral period, the Company is precluded from paying cash dividends to shareholders or repurchasing its stock.

The fair value guidance generally permits the measurement of selected eligible financial instruments at fair value at specified election dates. Effective January 1, 2008, the Company elected the fair value option for its junior subordinated debt issued under USB Capital Trust II. The rate paid on the junior subordinated debt issued under USB Capital Trust II is 3-month LIBOR plus 129 basis points, and is adjusted quarterly.

At June 30, 2012 the Company performed a fair value measurement analysis on its junior subordinated debt using a cash flow model approach to determine the present value of those cash flows. The cash flow model utilizes the forward 3-month LIBOR curve to estimate future quarterly interest payments due over the thirty-year life of the debt instrument, adjusted for deferrals of interest payments per the Company's election at September 30, 2009. These cash flows were discounted at a rate which incorporates a current market rate for similar-term debt instruments, adjusted for additional credit and liquidity risks associated with the junior subordinated debt. Although there is little market data in the current relatively illiquid credit markets, we believe the 7.39% discount rate used represents what a market participant would consider under the circumstances based on current market assumptions.

The fair value calculation performed at June 30, 2012 resulted in a pretax gain adjustment of $364,000 ($214,000, net of tax) for the quarter ended June 30, 2012 and a cumulative pretax loss adjustment of $112,000 ($66,000 net of tax). The previous year's fair value calculation performed at June 30, 2011 resulted in a pretax gain adjustment of $222,000 ($131,000, net of tax) for the quarter ended June 30, 2011 and a pretax loss adjustment of $145,000 ($85,000 net of tax) for the six months ended June 30, 2011.

11.Fair Value Measurements and Disclosure

The following summary disclosures are made in accordance with the guidance provided by ASC Topic 825 “Fair Value Measurements and Disclosures” (formerly Statement of Financial Accounting Standards No. 107, “Disclosures about Fair Value of Financial Instruments,”) which requires the disclosure of fair value information about both on- and off-balance sheet financial instruments where it is practicable to estimate that value.

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Generally accepted accounting guidance clarifies the definition of fair value, describes methods used to appropriately measure fair value in accordance with generally accepted accounting principles and expands fair value disclosure requirements. This guidance applies whenever other accounting pronouncements require or permit fair value measurements.

The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels (Level 1, Level 2, and Level 3). Level 1 inputs are unadjusted quoted prices in active markets (as defined) for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability, and reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk).

The table below is a summary of fair value estimates for financial instruments and the level of the fair value hierarchy within which the fair value measurements are categorized, excluding financial instruments recorded at fair value on a recurring or non-recurring basis at the periods indicated:

June 30, 2012					
(In thousands)	Carrying Amount	Estimated Fair Value	Quoted Prices In Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Financial Assets:					
Cash and cash equivalents	$99,390	$99,390	$ 99,390		
Interest-bearing deposits	2,103	2,104		$2,104	
Investment securities	35,553	35,553		27,241	$ 8,312
Loans	382,953	385,717			385,717
Cash surrender value of life insurance	16,413	16,413			16,413
Accrued interest receivable	1,755	1,755		1,755	
Financial Liabilities:					
Deposits:					
Noninterest-bearing	197,052	197,052	197,052		
NOW and money market	173,163	174,088	174,088		
Savings	40,041	39,014	39,014		
Time Deposits	114,746	114,941			114,941
Total Deposits	525,002	525,095	410,154		114,941
Junior Subordinated Debt	8,516	8,516			8,516
Accrued interest payable	826	826		826	
Commitments to extend credit	--	--	--	--	--
Standby letters of credit	--	--	--	--	--

December 31, 2011					
	Carrying	Estimated Fair	Quoted Prices In Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs

(In thousands)	Amount	Value	Level 1	Level 2	Level 3
Financial Assets:					
Cash and cash equivalents	$124,184	$124,184	$ 124,184		
Interest-bearing deposits	2,187	2,250		$2,250	
Investment securities	38,458	38,458		30,485	$ 7,973
Loans	394,498	398,837			398,837
Cash surrender value of life insurance	16,150	16,150			16,150
Accrued interest receivable	1,946	1,946		1,946	
Financial Liabilities:					
Deposits:					
Noninterest-bearing	224,907	224,907	224,907		
NOW and money market	165,937	165,937	165,937		
Savings	40,099	40,099	40,099		
Time Deposits	143,484	143,427			143,427
Total Deposits	574,427	574,370	430,943		143,427
Junior Subordinated Debt	9,027	9,027			9,027
Accrued interest payable	111	111		111	
Commitments to extend credit	--	--	--	--	--
Standby letters of credit	--	--	--	--	--

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The Company performs fair value measurements on certain assets and liabilities as the result of the application of current accounting guidelines. Some fair value measurements, such as for available-for-sale securities (AFS) and junior subordinated debt are performed on a recurring basis, while others, such as impairment of loans, other real estate owned, goodwill and other intangibles, are performed on a nonrecurring basis.

The Company's Level 1 financial assets consist of money market funds and highly liquid mutual funds for which fair values are based on quoted market prices. The Company's Level 2 financial assets include highly liquid debt instruments of U.S. government agencies, collateralized mortgage obligations, and debt obligations of states and political subdivisions, whose fair values are obtained from readily-available pricing sources for the identical or similar underlying security that may, or may not, be actively traded. Level 2 financial assets also include certain impaired loans which are evaluated based on the observable inputs, specifically current appraisals. The Company's Level 3 financial assets include certain investments securities, certain impaired loans, other real estate owned, goodwill, and intangible assets where the assumptions may be made by us or third parties about assumptions that market participants would use in pricing the asset or liability. From time to time, the Company recognizes transfers between Level 1, 2, and 3 when a change in circumstances warrants a transfer. There were no significant transfers in or out of Level 1 and Level 2 fair value measurements during the six months ended June 30, 2012.

The following tables summarize the Company's assets and liabilities that were measured at fair value on a recurring and non-recurring basis as of June 30, 2012 (in 000's):

Description of Assets	June 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
AFS Securities (2):				
U.S. government agencies	22,829		22,829	
U.S. government agency CMO's	4,412		4,412	
Residential mortgage obligations	8,312			$ 8,312
Total AFS securities	35,553		27,241	8,312
Impaired loans (1):				
Commercial and industrial	9,740			9,740
Real estate mortgage	10,870			10,870
RE construction & development	6,148			6,148
Agricultural	719			719
Installment/Other	89			89
Total impaired loans	27,566			27,566
Other real estate owned (1)	23,894			23,894
Total	$ 87,013	$ 0	$ 27,241	$ 59,772

(1) Nonrecurring
(2) Recurring

	Quoted Prices in	Significant Other	Significant Unobservable Inputs

Description of Liabilities	June 30, 2012	Active Markets for Identical Assets (Level 1)	Observable Inputs (Level 2)	(Level 3)
Junior subordinated debt (2)	$ 9,276			$ 9,276
Total	$ 9,276			$ 9,276

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The following tables summarize the Company's assets and liabilities that were measured at fair value on a recurring and non-recurring basis as of December 31, 2011 (in 000's):

Description of Assets (000's)	December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
AFS Securities: (2)				
Other investment securities	$0	$ 0		
U.S Govt agencies	25,050		25,050	
U.S Govt collateralized mortgage obligations	5,435		5,435	
Obligations of state and political subdivisions	0		0	
Private label residential mortgage obligations	7,973			7,973
Total AFS securities	38,458	0	30,485	7,973
Impaired Loans (1):				
Commercial and industrial	6,527			6,527
Real estate mortgage	11,181			11,181
RE construction & development	11,361			11,361
Agricultural	1,472			1,472
Installment/Other	87			87
Total impaired loans	30,628	0	0	30,628
Other real estate owned (1)	27,091			27,091
Goodwill (1)	2,861			2,861
Total	$99,038	$ 0	$30,485	$ 68,553

(1) Nonrecurring
(2) Recurring

Description of Liabilities (000's)	December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Junior subordinated debt (2)	9,027			9,027
Total	9,027			9,027

There were no fair value impairment adjustments for the nonrecurring fair value measurements performed during the six months ended June 30, 2012.

The following tables provide a reconciliation of assets and liabilities at fair value using significant unobservable inputs (Level 3) on a recurring basis during the six months ended June 30, 2012 and 2011 (in 000's):

Reconciliation of Assets:	6/30/12 Private label	6/30/11 Private label

	mortgage-backed securities	mortgage-backed securities
Beginning balance	$ 7,973	$ 9,960
Total gains or (losses) included in other comprehensive income	339	(1,110)
Transfers in and/or out of Level 3	0	0
Ending balance	$ 8,312	$ 8,850
The amount of total gains or (losses) for the period included in earnings (or other comprehensive loss) attributable to the change in unrealized gains or losses relating to assets still held at the reporting date	$ 339	$ 0

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Reconciliation of Liabilities:	6/30/12 Junior Subordinated Debt	6/30/11 Junior Subordinated Debt
Beginning balance	$ 9,027	$ 10,646
Total losses (gains) included in earnings (or changes in net assets)	112	145
Transfers in and/or (out) of Level 3	137	121
Ending balance	$ 9,276	$ 10,912
The amount of total losses (gains) for the period included in earnings attributable to the change in unrealized gains or losses relating to liabilities still held at the reporting date	$ 112	$ 145

The following methods and assumptions were used in estimating the fair values of financial instruments:

Cash and Cash Equivalents - The carrying amounts reported in the balance sheets for cash and cash equivalents approximate their estimated fair values.

Interest-bearing Deposits – Interest bearing deposits in other banks consist of fixed-rate certificates of deposits. Accordingly, fair value has been estimated based upon interest rates currently being offered on deposits with similar characteristics and maturities.

Investments – Available for sale securities are valued based upon open-market price quotes obtained from reputable third-party brokers that actively make a market in those securities. Market pricing is based upon specific CUSIP identification for each individual security. To the extent there are observable prices in the market, the mid-point of the bid/ask price is used to determine fair value of individual securities. If that data are not available for the last 30 days, a Level 2-type matrix pricing approach based on comparable securities in the market is utilized. Level-2 pricing may include using a forward spread from the last observable trade or may use a proxy bond like a TBA mortgage to come up with a price for the security being valued. Changes in fair market value are recorded through other comprehensive loss as the securities are available for sale. At June 30, 2012 and December 31, 2011, the Company held three non-agency (private-label) collateralized mortgage obligations (CMO's). Fair value of these securities (as well as review for other-than-temporary impairment) was performed by a third-party securities broker specializing in CMO's using the discounted cash flow method. Fair value was based upon estimated cash flows which included assumptions about future prepayments, default rates, and the impact of credit risk on this type of investment security. Although the pricing of the CMO's has certain aspects of Level 2 pricing, many of the pricing inputs are based upon unobservable assumptions of future economic trends and as a result the Company considers this to be Level 3 pricing.

Loans - Fair values of variable rate loans, which reprice frequently and with no significant change in credit risk, are based on carrying values adjusted for credit risk. Fair values for all other loans, except impaired loans, are estimated using discounted cash flows over their remaining maturities, using interest rates at which similar loans would currently be offered to borrowers with similar credit ratings and for the same remaining maturities.

Impaired Loans - Fair value measurements for impaired loans are performed pursuant to authoritative accounting guidance and are based upon either collateral values supported by appraisals, observed market prices, or discounted cash flows. Changes are not recorded directly as an adjustment to current earnings or comprehensive income, but rather as an adjustment component in determining the overall adequacy of the loan loss reserve. Such adjustments to the estimated fair value of impaired loans may result in increases or decreases to the provision for credit losses recorded in current earnings.

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Other Real Estate Owned - Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned (OREO) are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Goodwill and Core Deposit Intangibles - Goodwill is not amortized but is evaluated periodically for impairment. Fair value of goodwill is determined by comparing the fair value of the operating unit with its carrying value. Fair value is determined on a discounted cash flow methodology using estimated market discount rates and projections of future cash flows for the related operating unit. In addition to projected cash flows, other market metrics are utilized including industry multiples of earnings and price-to-book ratios to estimate what a market participant would pay for the operating unit in the current business environment. Determining the fair value involves a significant amount of judgment, including estimates of changes in revenue growth, changes in discount rates, competitive forces within the industry, and other specific industry and market valuation conditions. If it is determined that goodwill impairment exists, impairment amounts are recorded as an impairment loss in other noninterest expense, and the carrying value of goodwill is reduced by the amount of the impairment. Core deposit intangibles are amortized over the estimated useful lives of the related deposits and are evaluated for impairment periodically. Core deposit intangibles are reviewed for impairment utilizing a discounted cash flow methodology based upon the anticipated deposit runoff over the estimated lives of the deposits, generally six to eight years. If it is determined that impairment exists on the core deposit intangible, impairment amounts are recorded as an impairment loss in other noninterest expense, and the carrying value of core deposit intangible is reduced by the amount of the impairment.

Bank-owned Life Insurance – Fair values of life insurance policies owned by the Company approximate the insurance contract’s cash surrender value.

Deposits – In accordance with authoritative accounting guidance, fair values for transaction and savings accounts are equal to the respective amounts payable on demand at June 30, 2012 and December 31, 2011 (i.e., carrying amounts). The Company believes that the fair value of these deposits is clearly greater than that prescribed under authoritative accounting guidance. Fair values of fixed-maturity certificates of deposit were estimated using the rates currently offered for deposits with similar remaining maturities.

Junior Subordinated Debt – The fair value of the junior subordinated debt was determined based upon a discounted cash flows model utilizing observable market rates and credit characteristics for similar debt instruments. In its analysis, the Company used characteristics that market participants generally use, and considered factors specific to (a) the liability, (b) the principal (or most advantageous) market for the liability, and (c) market participants with whom the reporting entity would transact in that market. For the three month period ended June 30, 2012, cash flows were discounted at a rate which incorporates a current market rate for similar-term debt instruments, adjusted for credit and liquidity risks associated with similar junior subordinated debt and circumstances unique to the Company. The Company believes that the subjective nature of theses inputs, due primarily to the current economic environment, require the junior subordinated debt to be classified as a Level 3 fair value.

Accrued Interest Receivable and Payable - The carrying value of these instruments is a reasonable estimate of fair value.

Off-balance sheet instruments - Off-balance sheet instruments consist of commitments to extend credit, standby letters of credit and derivative contracts. Fair values of commitments to extend credit are estimated using the interest rate currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present counterparties’ credit standing. There was no material difference between the contractual amount and the estimated value of commitments to extend credit at June 30, 2012 and December 31, 2011.

Fair values of standby letters of credit are based on fees currently charged for similar agreements. The fair value of commitments generally approximates the fees received from the customer for issuing such commitments. These fees are not material to the Company's consolidated balance sheet and results of operations.

12.Goodwill and Intangible Assets

At June 30, 2012 and December 31, 2011 the Company had goodwill, core deposit intangibles, and other identified intangible assets which were recorded in connection with various business combinations and purchases. The following table summarizes the carrying value of those assets at June 30, 2012 and December 31, 2011.

	June 30, 2012		December 31, 2011	
Goodwill	$	4,488	$	4,488
Core deposit intangible assets		342		447
Other identified intangible assets		41		106
Total goodwill and intangible assets	$	4,871	$	5,041

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Core deposit intangibles and other identified intangible assets are amortized over their useful lives, while goodwill is not amortized. The Company conducts periodic impairment analysis on goodwill and intangible assets at least annually or more often as conditions require.

Goodwill: The largest component of goodwill is related to the Legacy merger (Campbell reporting unit) completed during February 2007 and totaled approximately $2.9 million at June 30, 2012. Annually, the Company conducts its impairment testing of the goodwill related to the Campbell reporting unit. Impairment testing for goodwill is a two-step process.

The first step in impairment testing is to identify potential impairment, which involves determining and comparing the fair value of the operating unit with its carrying value. If the fair value of the reporting unit exceeds its carrying value, goodwill is not impaired. If the carrying value exceeds fair value, there is an indication of possible impairment and the second step is performed to determine the amount of the impairment, if any. The fair value determined in the step one testing is determined based on a discounted cash flow methodology using estimated market discount rates and projections of future cash flows for the Campbell reporting unit. In addition to projected cash flows, the Company also utilizes other market metrics including industry multiples of earnings and price-to-book ratios to estimate what a market participant would pay for the operating unit in the current business environment. Determining the fair value involves a significant amount of judgment, including estimates of changes in revenue growth, changes is discount rates, competitive forces within the industry, and other specific industry and market valuation conditions. If at the conclusion of the step 1 analysis, the Company concludes that the potential for goodwill impairment exists, step-two testing will be required to determine goodwill impairment and the amount of goodwill that might be impaired, if any. The second step in impairment analysis compares the fair value of the Campbell reporting unit to the aggregate fair values of its individual assets, liabilities and identified intangibles. The 2011 impairment analysis was impacted by to a large degree by the current economic environment, including significant declines in interest rates, and depressed valuations within the financial industry and resulted in an impairment charge of $1.5 million. Based on the results of the first step of the impairment analysis at June 30, 2012, the Company concluded that that the fair value of the reporting unit exceeds it carrying value. Therefore, goodwill was not impaired.

Core Deposit Intangibles: The core deposit intangible asset, which totaled $3.0 million at the time of merger, was amortized over an estimated life of approximately seven years. The Company recognized $12,000 and $158,000 in amortization expense related to the Legacy operating unit during the six months ended June 30, 2012 and 2011, respectively. At June 30, 2012, there was no remaining carrying value of the core deposit intangible related to the Legacy Bank merger.

During the impairment analysis performed as of March 31, 2011, it was determined that the original deposits purchased from Legacy Bank during February 2007 had declined faster than originally anticipated. As a result of increased deposit runoff, particularly in noninterest-bearing checking accounts and savings accounts, the estimated value of the Campbell core deposit intangible was determined to be $226,000 at March 31, 2011 rather than the pre-adjustment carrying value of $262,000. As a result of the impairment analysis, the Company recorded a pre-tax impairment loss of $36,000 ($21,000, net of tax) reflected as a component of noninterest expense for the six months ended June 30, 2011. The Company did not record an impairment loss for the three months or six months ended June 30, 2012.

13. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Unrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through the date the financial statements were issued.

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Item2 - Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Certain matters discussed or incorporated by reference in this Quarterly Report of Form 10-Q are forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Such risks and uncertainties include, but are not limited to, those described in Management's Discussion and Analysis of Financial Condition and Results of Operations. Such risks and uncertainties include, but are not limited to, the following factors: i) competitive pressures in the banking industry and changes in the regulatory environment; ii) exposure to changes in the interest rate environment and the resulting impact on the Company's interest rate sensitive assets and liabilities; iii) decline in the health of the economy nationally or regionally which could reduce the demand for loans or reduce the value of real estate collateral securing most of the Company's loans; iv) credit quality deterioration that could cause an increase in the provision for loan losses; v) Asset/Liability matching risks and liquidity risks; volatility and devaluation in the securities markets, vi) failure to comply with the regulatory agreements under which the Company is subject, vii) expected cost savings from recent acquisitions are not realized, and, viii) potential impairment of goodwill and other intangible assets. Therefore, the information set forth therein should be carefully considered when evaluating the business prospects of the Company. For additional information concerning risks and uncertainties related to the Company and its operations, please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

United Security Bancshares (the "Company" or "Holding Company") is a California corporation incorporated during March of 2001 and is registered with the Board of Governors of the Federal Reserve System as a bank holding company under the Bank Holding Company Act of 1956, as amended. United Security Bank (the "Bank") is a wholly-owned bank subsidiary of the Company and was formed in 1987. References to the Company are references to United Security Bancshares (including the Bank). References to the Bank are to United Security Bank, while references to the Holding Company are to the parent-only, United Security Bancshares. The Company currently has eleven banking branches, which provide financial services in Fresno, Madera, Kern, and Santa Clara counties in the state of California.

Effective March 23, 2010, United Security Bancshares (the "Company") and its wholly owned subsidiary, United Security Bank (the "Bank"), entered into a formal written agreement (the "Agreement") with the Federal Reserve Bank of San Francisco. The Agreement was a result of a regulatory examination that was conducted by the Federal Reserve and the California Department of Financial Institutions in June 2009 and is intended to improve the overall condition of the Bank through, among other things, increased Board oversight; formal plans to monitor and improve processes related to asset quality, liquidity, funds management, capital, and earnings; and the prohibition of certain actions that might reduce capital, including the distribution of dividends or the repurchase of the Company's common stock. The Board of Directors and management believe that the Company is in compliance with the terms of the Agreement. (For more information on the Agreement see the "Regulatory Matters" section included in this Management's Discussion and Analysis of Financial Condition and Results of Operations.)

During May of 2010, the California Department of Financial Institutions issued a written order (the "Order") to the Bank as a result of a regulatory examination that was conducted by the Federal Reserve and the California Department of Financial Institutions in June 2009. The Order issued by the California Department of Financial Institutions is similar to the written agreement with the Federal Reserve Bank of San Francisco. The Board of Directors and management believe that the Company is in compliance with the terms of the Agreement. (For more information on the Agreement see the "Regulatory Matters" section included in this Management's Discussion and Analysis of Financial Condition and Results of Operations.)

Trends Affecting Results of Operations and Financial Position

The Company's overall operations are impacted by a number of factors, including not only interest rates and margin spreads, which impact the results of operations, but also the composition of the Company's balance sheet. One of the primary strategic goals of the Company is to maintain a mix of assets that will generate a reasonable rate of return without undue risk, and to finance those assets with a low-cost and stable source of funds. Liquidity and capital resources must also be considered in the planning process to mitigate risk and allow for growth. Net interest income before provision for credit losses has decreased between the three and six months ended June 30, 2012 and 2011, totaling $6.0 million for the three months ended June 30, 2012 as compared to $6.3 million for the three months ended June 30, 2011, and $12.1 million for the six months ended June 30, 2012 as compared to $12.5 million for the six months ended June 30, 2011. The decrease in net interest income between 2012 and 2011 was primarily the result of declines in the volume of interest-earning assets which outweighed the decrease in the Company's cost of funding between the two periods.

Average interest-earning assets decreased approximately $46.1 million between the six month periods ended June 30, 2012 and June 30, 2011. Components of the $46.1 million decrease in average earning assets between 2011 and 2012 included a decrease of $36.1 million in loans and a $13.9 million decrease in investment securities. Offsetting these decreases between the six-month comparative periods was an increase of $4.5 million in federal funds sold to the Federal Reserve Bank. During the last year, the Company's cost of interest-bearing liabilities has declined significantly as market rates of interest declined, with the average cost of interest-bearing liabilities dropping from .75% during the six months ended June 30, 2011, to 0.63% during the six months ended June 30, 2012.

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The following table summarizes the year-to-date averages of the components of interest-earning assets as a percentage of total interest-earning assets and the components of interest-bearing liabilities as a percentage of total interest-bearing liabilities:

	YTD Average 6/30/12		YTD Average 12/31/11		YTD Average 6/30/11	
Loans and Leases	76.88	%	76.39	%	77.01	%
Investment securities available for sale	7.16	%	8.80	%	9.05	%
Interest-bearing deposits in other banks	0.41	%	0.43	%	0.45	%
Interest-bearing deposits in FRB	15.55	%	14.38	%	13.49	%
Total interest-earning assets	100.00	%	100.00	%	100.00	%
NOW accounts	14.60	%	11.80	%	11.61	%
Money market accounts	35.00	%	30.43	%	29.36	%
Savings accounts	11.91	%	9.67	%	9.17	%
Time deposits	35.92	%	40.21	%	41.17	%
Other borrowings	0.00	%	5.43	%	6.21	%
Subordinated debentures	2.57	%	2.46	%	2.48	%
Total interest-bearing liabilities	100.00	%	100.00	%	100.00	%

The residential real estate markets in the five county region from Merced to Kern showed signs of improvement during 2011 and those trends continued into the first and second quarters of 2012. The severe declines in residential construction and home prices that began in 2008 continues to show signs of easing and reversing direction. The sustained period of double-digit price declines from 2008 – 2011 adversely impacted the Company's operations and increased the levels of nonperforming assets, expenses related to foreclosed properties, and decreased profit margins. As the Company continues its business development and expansion efforts throughout its market areas, a primary focus is reduction of nonperforming assets while providing customers options to work through this difficult economic period. Options include combinations of rate and term concessions, as well as forbearance agreements with borrowers. Median sales prices improved in the five county region from Merced to Kern between June 2011 to June 2012. Total nonperforming loans decreased during the six months ended June 30, 2012, totaling $28.9 million at June 30, 2012 compared to $30.0 million reported at December 31, 2011.

As a result of the weak economy, the Company has experienced declines in the loan portfolio between 2011 and 2012. During the six months ended June 30, 2012 and between June 30, 2011 and June 30, 2012, the Company experienced increases in real estate mortgage loans, but decreases were experienced in all other loan categories. In order from greatest to least, decreases over the past year have been experienced in commercial and industrial loans, real estate construction and development loans, and agricultural loans, as the Company has reduced its exposure to real estate markets which have been hard hit during the economic downturn. Loans decreased $13.6 million between December 31, 2011 and June 30, 2012, and decreased $28.3 million between June 30, 2011 and June 30, 2012. Commercial and industrial loans decreased $22.8 million between December 31, 2011 and June 30, 2012 and $25.1 million between June 30, 2011 and June 30, 2012. Real estate construction and development loans increased $233,000 between December 31, 2011 and June 30, 2012, but decreased $5.6 million between June 30, 2011 and June 30, 2012, as real estate construction remains depressed in the San Joaquin Valley and California overall. Agricultural loans decreased $6.9 million between December 31, 2011 and June 30, 2012 and $8.5 million between June 30, 2011 and June 30, 2012. Commercial real estate loans (a component of real estate mortgage loans) have remained as a significant percentage of total loans over the past year, amounting to 33.5%, 29.1%, and 28.4%, of the total loan portfolio at June 30, 2012, December 31, 2011, and June 30, 2011, respectively. Residential mortgage loans are not generally a large part of the Company's loan portfolio, but some residential mortgage loans have been made over the past several years to facilitate take-out loans for construction borrowers when they were not able to obtain permanent financing elsewhere. These loans are generally 30-year amortizing loans with maturities of between three and five years. Residential mortgages totaled $25.4 million or 6.4% of the portfolio at June 30, 2012, $24.0 million, or 5.9% of the portfolio at December 31, 2011, and $25.1 million or 5.9% of the portfolio at June 30, 2011. Loan participations purchased have declined from $13.2 million or 3.0% of the portfolio at June 30, 2011, to $3.6 million or 0.9% of the portfolio at December 31, 2011, to $2.17 million or .5% of the portfolio at June 30, 2012. Loan participations sold increased from $8.2 million or 1.9% of the portfolio at June 30, 2011, to $13.3 million or 3.3% of the portfolio at December 31, 2011, compared to $11.5 million, or 2.9%, at June 30, 2012.

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Even though market rates of interest are at historically low levels, the Company's disciplined deposit pricing efforts have helped maintain adequate margins, The Company's net interest margin increased to 4.69% for the six months ended June 30, 2012, as compared to 4.47% for the six months ended June 30, 2011. The net interest margin has also been impacted by a decline in loan volume, the Company's highest yielding asset, which has been partially offset by an increase in overnight investments with the Federal Reserve Bank, a much lower yielding asset. The Company has successfully sought to mitigate the low-interest rate environment with loan floors included in new and renewed loans when practical. Loans yielded 6.08% during the six months ended June 30, 2012, as compared to 5.97% for the six months ended June 30, 2011. The decrease in the Company's cost of funds over the past year and has mitigated the impact of declining yields on earning assets. The Company's average cost of funds was 0.63% for the six months ended June 30, 2012 as compared to 0.75% for the six months ended June 30, 2011. Although the Company does not intend to increase its current level of brokered deposits, and in fact as a result of the 2010 Agreement with the Federal Reserve Bank and Order with the California Department of Financial Institutions, continues to systematically reduce brokered deposit levels as they mature in the future, the $30.5 million in brokered deposits at June 30, 2012 continues to provide the Company with a low-cost source of deposits. The Company will continue to utilize these funding sources when required to maintain prudent liquidity levels, while seeking to increase core deposits when possible.

Total noninterest income of $4.6 million reported for the six months ended June 30, 2012 increased $2.3 million or 98.0% as compared to the six months ended June 30, 2011. Noninterest income continues to be driven by customer service fees, which totaled $1.8 million for the six months ended June 30, 2012, however the increase in noninterest income between the six months ended June 30, 2012 and June 30, 2011, was primarily the result of increases of $1.8 million in the gain on sale of investments as well as the increase in the gain on sale of other real estate owned of $385,000 between the two six-month periods. The gain on sale of investments was related to the sale of income tax credits, the benefit of which was delayed due to the bank's sizeable net operating loss carry-forwards. The sale effectively saves the Bank $470,000 of amortization expense over each of the next 3 years, as well as generated the gain in 2012.

Noninterest expense decreased approximately $3.8 million or 26.8% between the six months ended June 30, 2011 and June 30, 2012. Decreases experienced during the six months ended June 30, 2012 were primarily the result of decreases in professional fees, a decrease in impairment loss on goodwill and a decrease in impairment loss on other real estate owned.

Effective September 30, 2009 and beginning with the quarterly interest payment due October 1, 2009, the Company deferred interest payments on the Company's $15.0 million of junior subordinated debentures relating to its trust preferred securities. This was the result of regulatory restraints which have precluded the Bank from paying dividends to the Holding Company. The Agreement with the Federal Reserve Bank entered into during March 2010 specifically prohibits the Company and the Bank from making any payments on the junior subordinated debt without prior approval of the Federal Reserve Bank. The terms of the debentures and trust indentures allow for the Company to defer interest payments for up to 20 consecutive quarters without default or penalty. During the period that the interest deferrals are elected, the Company will continue to record interest expense associated with the debentures. Upon the expiration of the deferral period, all accrued and unpaid interest will be due and payable. Under the terms of the debenture, the Company is precluded from paying cash dividends to shareholders or repurchasing its stock during the deferral period.

The Company has not paid any cash dividends on its common stock since the second quarter of 2008 and does not expect to resume cash dividends on its common stock for the foreseeable future. Because the Company has elected to defer the quarterly payments of interest on its junior subordinated debentures issued in connection with the trust preferred securities as discussed above, the Company is prohibited under the subordinated debenture agreement from paying cash dividends on its common stock during the deferral period. In addition, pursuant to the Agreement entered into with the Federal Reserve Bank during March of 2010, the Company and the Bank are precluded from paying cash dividends without prior consent of the Federal Reserve Bank. On June 26, 2012, the Company's Board of Directors declared a one-percent (1%) quarterly stock dividend on the Company's outstanding common stock. The Company believes, given the current uncertainties in the economy and unprecedented declines in real estate valuations in our markets, it is prudent to retain capital in this environment, and better position the Company for future growth opportunities. Based upon the number of outstanding common shares on the record date of July 13, 2012, an additional 136,654 shares were issued to shareholders. For purposes of earnings per share calculations, the Company's weighted average shares outstanding and potentially dilutive shares used in the computation of earnings per share have been restated after giving retroactive effect to the 1% stock dividends to shareholders for all periods presented.

The Company has sought to maintain a strong, yet conservative balance sheet while continuing to reduce the level of nonperforming assets and improve liquidity during the six months ended June 30, 2012. Total assets decreased approximately $45.7 million during the six months ended June 30, 2012, including a decrease of $13.6 million in loans, a decrease of $24.8 million in cash and cash equivalents, and a decrease of $3.2 million in OREO. Total deposits decreased $49.4 million, including decreases of $27.9 million in noninterest-bearing deposits and $28.7 million in time deposits during the six months ended June 30, 2012 not offset by the increases in savings and NOW and money market accounts. The decrease in time deposits during the six-month period was the result of Company's continued efforts to reduce the level of brokered time deposits. Average loans comprised approximately 77% of overall average earning assets during the six months ended June 30, 2012 and June 30, 2011.

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Nonperforming assets, which are primarily related to the real estate loan and property portfolio, remained high during the six months ended June 30, 2012, but decreased $4.3 million from a balance of $57.0 million at December 31, 2011 to a balance of $52.7 million at June 30, 2012. Nonaccrual loans totaling $18.2 million at June 30, 2012, increased $91,000 from the balance of $18.1 million reported at December 31, 2011. In determining the adequacy of the underlying collateral related to these loans, management monitors trends within specific geographical areas, loan-to-value ratios, appraisals, and other credit issues related to the specific loans. Valuations on these loans and the underlying collateral continued to deteriorate during much of 2009, 2010, and 2011, resulting in increased charge-offs and levels of impaired loans. Impaired loans decreased $3.5 million during the six months ended June 30, 2012 with a balance of $28.4 million at June 30, 2012. Other real estate owned through foreclosure decreased $3.2 million between December 31, 2011 and June 30, 2012 as a result of the sale of six properties. As a result of the related events, nonperforming assets as a percentage of total assets decreased from 13.96% at December 31, 2011 to 8.72% at June 30, 2012.

The following table summarizes various nonperforming components of the loan portfolio, the related allowance for loan and lease losses and provision for credit losses for the periods shown.

(in thousands)	June 30, 2012		December 31, 2011		June 30, 2011 (restated)	
Provision for credit losses during period	$ 1,006		$ 13,602		$ 10,051	
Allowance as % of nonperforming loans	40.26	%	45.52	%	41.71	%
Nonperforming loans as % total loans	7.31	%	7.34	%	8.09	%
Restructured loans as % total loans	4.24	%	4.67	%	5.41	%

Management continues to monitor economic conditions in the real estate market for signs of further deterioration or improvement which may impact the level of the allowance for loan losses required to cover identified losses in the loan portfolio. Greater focus has been placed on monitoring and reducing the level of problem assets, while working with borrowers to find more options, including loan restructures, to work through these difficult economic times. Restructured loans were comprised of 42 loans totaling $16.8 million at June 30, 2012, compared to 41 loans totaling $19.0 million at December 31, 2011.

Provisions made to the allowance for credit losses, totaled $1.0 million during the six months ended June 30, 2012 as compared to $10.1 million for the six months ended June 30, 2011. Net loan and lease charge-offs during the six months ended June 30, 2012 totaled $3.1 million as compared to $13.4 million for the six months ended June 30, 2011. The Company charged-off, or had partial charge-offs on, approximately 15 loans during the six months ended June 30, 2012, compared to 39 loans during the six months ended June 30, 2011, and 78 loans during year ended December 31, 2011. The annualized percentage charge-offs to average loans were 0.1.54% and 5.89% for the six months ended June 30, 2012 and 2011, respectively, as compared to 3.9% for the year ended December 31, 2011.

Deposits decreased by $49.4 million during the six months ended June 30, 2012, with decreases experienced in noninterest-bearing accounts and time deposits, more than offsetting the increases in savings and NOW and money market accounts during the first six months of 2012. Decreases in time deposits experienced during the six months ended June 30, 2012 were primarily the result of decreases in brokered wholesale deposits, as the Company continues to reduce its reliance on brokered deposits and other wholesale funding sources, while maintaining sufficient liquidity.

Brokered deposits have provided the Company a relatively inexpensive funding source over the past several years totaling $30.5 million or 5.8% of total deposits at June 30, 2012, as compared to $49.3 million or 8.6% of total deposits at December 31, 2011, and $54.2 million or 9.9% of total deposits at June 30, 2011. Brokered deposits and other wholesale funding sources were used to some degree to fund loan growth in 2007 and 2008, but the current state of the economy and the financial condition of the Company have made it increasingly important to continue to develop core deposits and reduce the Company's dependence on brokered and other wholesale funding sources, including lines of credit with the Federal Reserve Bank and the FHLB. The Company continues its efforts to develop core deposit growth with employee training throughout the entire organization and a deposit-gathering program that incents employees to bring in new deposits from our local market area and establish more extensive relationships with our customers. As part of its liquidity position improvement plan resulting from the formal agreement with the Federal Reserve Bank issued in March 2010, the Company has reduced its reliance on brokered deposits and will continue to do so in order to achieve levels more comparable with peers, which is currently about 5% of total deposits. The Company will seek to replace maturing brokered deposits with core deposits, but may also control loan growth to help achieve that objective.

The cost of the Company's subordinated debentures issued by USB Capital Trust II has remained low as market rates have remained low during the first six months of 2012. With pricing at 3-month-LIBOR plus 129 basis points, the effective cost of the subordinated debt was 1.75% at June 30, 2012 as compared to 1.89% at December 31, 2011. Pursuant to fair value accounting guidance, the Company has recorded $364,000 in pretax fair value gain on its junior subordinated debt during the quarter ended June 30, 2012, bringing the total cumulative gain recorded on the debt to $6.9 million at June 30, 2012.

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The Company continues to emphasize relationship banking and core deposit growth, and has focused greater attention on its market area of Fresno, Madera, and Kern Counties, as well as Campbell, in Santa Clara County. The San Joaquin Valley and other California markets continue to exhibit weak demand for construction lending and commercial lending from small and medium size businesses, as commercial and residential real estate markets remain depressed, compared with prior years.

The Company continually evaluates its strategic business plan as economic and market factors change in its market area. Balance sheet management, enhancing revenue sources, and maintaining market share will be of primary importance during 2012 and beyond. The banking industry is currently experiencing continued pressure on net margins as well as asset quality resulting from conditions in the real estate market, and weak credit markets. During March 2010, the Company and the Bank entered into a regulatory agreement with the Federal Reserve Bank which, among other things, requires improvements in the overall condition of the Company and the Bank. As a result, market rates of interest, asset quality, as well as regulatory oversight will continue be an important factor in the Company's ongoing strategic planning process.

Results of Operations

For the quarter ended June 30, 2012, the Company reported net income of $2.2 million or $0.16 per share ($0.16 diluted) as compared to a net loss of $6.3 million or ($0.46) per share (($0.46) diluted) for the quarter ended June 30, 2011. On a year to date basis, the Company reported net income of $3.2 million or $0.23 per share ($0.23 diluted) for the six months ended June 30, 2012 as compared to a net loss of $6.0 million for the six months ended June 30, 2011. The increase in earnings between the quarters and six months ended June 30, 2012 and 2011 are a result of decreases in interest expense and the provision for loan losses, and increases in noninterest income combined with a decrease in noninterest expense.

The Company's return on average assets was 1.05% for the six months ended June 30, 2012 as compared to (1.81%) for the six months ended June 30, 2011 and was 1.42% for the quarter ended June 30, 2012 compared to (3.82%) for the quarter ended June 30, 2011. The Bank's return on average equity was 10.18% for the six months ended June 30, 2012 as compared to (15.63%) for the six months ended June 30, 2011 and was 11.54% for the quarter ended June 30, 2012 compared to (31.64%) for the quarter ended June 30, 2011.

Net Interest Income

Net interest income before provision for credit losses totaled $12.1 million for the six months ended June 30, 2012, representing a decrease of $454,000, or 3.6% when compared to the $12.5 million reported for the same six months of the previous year.

The Company's year-to-date net interest margin, as shown in Table 1, increased to 4.69% at June 30, 2012 from 4.47% at June 30, 2011, an increase of 22 basis points (100 basis points = 1%) between the two periods. While average market rates of interest have remained level between the six-month periods ended June 30, 2012 and 2011 (the Prime rate averaged 3.25% during both periods), the continued decrease in the Company's interest expenses positively impacted the net margin between the two six-month periods.

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Table 1. Distribution of Average Assets, Liabilities and Shareholders' Equity:
Interest rates and Interest Differentials
Six Months Ended June 30, 2012 and 2011

	2012	2011
(dollars in thousands)		