Oak Valley Bancorp
Form 10-K
March 27, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number: 001-34142

OAK VALLEY BANCORP

(Exact name of registrant as specified in its charter)

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

(209) 848-2265

(Registrant’s telephone number including area code)

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

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

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

None

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes No

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

Indicate by check mark whether the registrant has submitted electronically 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). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of June 30, 2016, the last business day of the Registrant’s most recently completed second fiscal quarter, the aggregate market value of the registrant’s common stock held by non-affiliates of the registrant, based upon the closing price of $9.75 per share of the registrant’s common stock as reported by the NASDAQ, was approximately $66 million. As of March 20, 2017, there were 8,082,205 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s Proxy Statement for the Annual Meeting of Shareholders will filed with the Commission within 120 days after the end of the Registrant’s 2016 fiscal year end and are incorporated by reference into Part III of this report.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K (Annual Report) includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, (the "1933 Act") and Section 21E of the Securities Exchange Act of 1934, as amended, (the "1934 Act"). Those sections of the 1933 Act and 1934 Act provide a "safe harbor" for forward-looking statements to encourage companies to provide prospective information about their financial performance so long as they provide meaningful, cautionary statements identifying important factors that could cause actual results to differ significantly from projected results.

All statements contained in this Annual Report other than statements of historical fact, including, for example, statements regarding descriptions of plans or objectives of management for future operations, products or services, forecasts of our revenues, earnings or other measures of economic performance, our assessment of significant factors and developments that may affect our results, regulatory controls and processes and their impact on our business, our business strategy and plans and our objectives for future operations, are forward-looking statements. The words "believe," "may," "will," "potentially," "estimate," "continue." "anticipate," "intend," "could," "would," "project," "plan" "ex expressions that convey uncertainty of future events or outcomes are intended to identify forward-looking statements.

We have based these forward-looking statements on our current expectations and projections about future events and trends. These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including those listed in this "Special Note Regarding Forward-Looking Statements," and those described in Part II, Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations." Moreover, we operate in a very competitive and rapidly changing environment, and new risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties, and assumptions, the forward-looking events and circumstances discussed in this Annual Report may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

You should not rely upon forward-looking statements as predictions of future events. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee that the future results, levels of activity, performance or events and circumstances reflected in the forward-looking statements will be achieved or occur. We undertake no obligation to update publicly any forward-looking statements to conform these statements to actual results or to changes in our expectations, except as required by law. You should read this Annual Report with the understanding that our actual future results, levels of activity, performance and events and circumstances may be materially different from what we expect.

PART I

ITEM 1. BUSINESS OF OAK VALLEY BANCORP

Overview of the Business

Oak Valley Bancorp. Oak Valley Bancorp (the "Company") was incorporated on April 1, 2008 in California for the purpose of becoming Oak Valley Community Bank's parent bank holding company. Effective July 3, 2008, Oak Valley Bancorp acquired all of the outstanding capital stock of Oak Valley Community Bank (the "Bank") (from time to time, the Bank and the Company may be generally referred to as "we", "us" or "our"). The principal office of Oak Valley Bancorp is located at 125 North Third Avenue, Oakdale, California 95361 and its principal telephone is (209) 848-2265.

The Company is authorized to issue 50,000,000 shares of common stock, without par value, of which 8,088,455 are issued and outstanding at December 31, 2016, and 10,000,000 shares of preferred stock, without par value, of which no shares are issued and outstanding.

The Company is the holding company of the Bank, and its only assets are the outstanding capital stock of the Bank, which the Company wholly owns, cash and income tax benefits receivable classified as other assets.

Oak Valley Community Bank. The Bank commenced operations in May 1991. The Bank is an insured bank under the Federal Deposit Insurance Act and is a member of the Federal Reserve. The Bank is subject to regulation, supervision and regular examination by the California Department of Business Oversight (DBO), the Federal Deposit Insurance Commission (FDIC) and the Federal Reserve Board (FRB). Since its formation, the Bank has provided basic banking services to individuals and business enterprises in Oakdale, California and the surrounding areas. The focus of the Bank is to offer a range of commercial banking services designed for both individuals and small to medium-sized businesses in the two main areas of service of the Bank: the Central Valley and the Eastern Sierras.

The Bank offers a complement of business checking and savings accounts for its business customers. The Bank also offers commercial and real estate loans, as well as lines of credit. Real estate loans are generally of a short-term nature for both residential and commercial lending purposes. Longer-term real estate loans are generally made with adjustable interest rates and contain customary provisions for acceleration. Traditional residential mortgages are available to Bank customers through a third party.

The Bank offers other services for both individuals and businesses including online banking, remote deposit capture, mobile banking, merchant services, night depository, extended hours, wire transfer of funds, note collection, and automated teller machines in a national network. The Bank does not currently offer international banking or trust services although the Bank may make such services available to the Bank's customers through financial institutions with which the Bank has correspondent banking relationships. The Bank does not offer stock transfer services nor does it directly issue credit cards.

On December 23, 2015, the Company completed its acquisition of Mother Lode Bank ("MLB"), a California state-chartered bank headquartered in Sonora, California, in a transaction in which Mother Lode Bank was merged with and into the Bank, with the Bank as the surviving company in the transaction. The purchase price for Mother Lode Bank was approximately $7.3 million. As of the acquisition date, Mother Lode Bank's total assets were $78.7 million and total deposits were $71.1 million.

Expansion

Branch Expansion. Since opening our doors of the main Oakdale branch in 1991, our network of branches and loan production offices have been expanded geographically. As of December 31, 2015, we maintained eighteen full-service branch offices (in addition to our corporate headquarters). Beginning in October 1995, we started our geographic expansion outside of Oakdale, by opening a Loan Production Office in Sonora, California. We subsequently opened a branch in Sonora and two branches in Modesto. In September 2000, we expanded into the Eastern Sierra, opening a branch in Bridgeport, California under the name Eastern Sierra Community Bank. Since that time we have added branches in Mammoth Lakes and Bishop. During 2005 and 2006, we aggressively increased our presence in the Central Valley, by opening branches in Turlock, Stockton, Patterson, Ripon and Escalon. In March 2007, our corporate headquarters expanded by adding an adjacent historical building located in downtown Oakdale to our complex. In 2011, we opened a third branch in Modesto and a branch in Manteca. In 2014, we opened a new branch in Tracy. In 2015, we added a second branch in Sonora. Later in 2015, Mother Lode Bank was merged with and into the Bank, which temporarily added two more branches in Sonora until they were eventually closed in January 2016, decreasing our total number of branches to sixteen, after management determined that our two existing branches would be able to serve our existing customers and the former Mother Lode Bank customers. We intend to continue our growth strategy in future years through the opening of additional branches and loan production offices as demand dictates and resources permit.

Bank Holding Company Reorganization. Effective July 3, 2008, we entered into a bank holding company reorganization, whereby each outstanding share of common stock of the Bank was exchanged into a share of common stock of the Company. Operating our banking business within a holding company structure provides, among other things, greater operating flexibility; facilitates the potential acquisition of related businesses as opportunities may arise from time to time; improves our ability to diversify as needed; enhances our ability to remain competitive in the future with other companies in the financial services industry that are organized in a holding company structure; and improves our ability to raise capital to support growth.

Business Segments

The Bank operates in two primary lines of business: Retail Banking and Commercial Banking, as described in additional detail below. These business lines do not meet the quantitative thresholds for reporting as separate segments and are therefore considered one segment for financial reporting purposes.

Retail Banking. We offer a range of checking and savings accounts, including NOW accounts, money market accounts, overdraft protection, health savings accounts, certificates of deposit, and Individual Retirement Accounts (“IRA”). To satisfy the lending needs of individuals in its service area, we offer real estate and home equity financing, as well as consumer, automobile, and home improvement loans.

Commercial Banking. We offer a range of deposit and lending services to business customers. More specifically, we offer a variety of commercial loans for virtually any business, professional, or agricultural need. These include loans for short-term working capital, operating lines of credit, equipment purchases, leasehold improvements, construction, commercial real estate acquisitions or refinancing. Currently, virtually all of our business relationships are with customers located in the San Joaquin, Stanislaus, Tuolumne, Inyo and Mono Counties, of California.

Primary Market Area

We conduct business from our main office in Oakdale, a city of approximately 21,500 residents located in Stanislaus County, California. Oakdale is approximately 15 miles from Modesto and sits at the foothills of the Sierra Nevada Mountains, at the edge of the California Central Valley agricultural area. Through our branches, we serve customers in the Central Valley, from Fresno to Sacramento, and in foothill locations. We also reach into the Highway 395 corridor in the Eastern Sierras and in the towns of Bishop, Mammoth and Bridgeport. Approximately 90% of our loans and 92% of our deposits are generated from the Central Valley. The Central Valley area includes Stanislaus, San Joaquin and Tuolumne counties and has a total population of over 3 million.

Lending Activities

General. Our loan policies set forth the basic guidelines and procedures by which we conduct our lending operations. These policies address the types of loans available, underwriting and collateral requirements, loan terms, interest rate and yield considerations, compliance with laws and regulations and our internal lending limits. Our Board of Directors reviews and approves our loan policies on an annual basis. We supplement our own supervision of the loan underwriting and approval process with periodic loan audits by experienced external loan specialists who review credit quality, loan documentation and compliance with laws and regulations. We engage in a full complement of lending activities, including:

commercial real estate loans,

commercial business lending and trade finance,

Small Business Administration lending, and

consumer loans, including automobile loans, home mortgages, credit lines and other personal loans.

As part of our efforts to achieve long-term stable profitability and respond to a changing economic environment in the California Central Valley, we constantly evaluate a variety of options to augment our traditional focus by broadening the services and products we provide. Possible avenues of growth include more branch locations, expanded suite of technology based services and new types of lending.

Loan Procedures. Loan applications may be approved by the Director Loan Committee of our Board of Directors, or by our management or lending officers, to the extent of their loan authority. Our Board of Directors authorizes our lending limits. Our President and Chief Credit Officer are responsible for evaluating the authority limits for individual credit officers and recommending lending limits for all other officers to the board of directors for approval.

We grant individual lending authority to our Chief Executive Officer, Chief Credit Officer, Credit Administrator and to some department managers and loan officers. Our highest management lending authority is combined administrative lending authority for unsecured and secured lending of $2,500,000, which requires the joint approval of either Chief Executive Officer, Chief Credit Officer, Senior Lending Officer and Credit Administrator. Loans for which direct and indirect borrower liability exceeds combined administrative lending authority are referred to our Board of Directors Loan Committee.

At December 31, 2016, the Bank's authorized legal lending limits were $13.0 million for unsecured loans plus an additional $8.7 million for specific secured loans. Legal lending limits are calculated in conformance with California law, which prohibits a bank from lending to any one individual or entity or its related interests an aggregate amount which exceeds 15% of primary capital plus the allowance for loan losses on an unsecured basis, plus an additional 10% on a secured basis. The Bank's primary capital plus allowance for loan losses at December 31, 2016 totaled $86.6 million.

We seek to mitigate the risks inherent in our loan portfolio by adhering to certain underwriting practices. The review of each loan application includes analysis of the applicant's prior credit history, income level, cash flow and financial condition, tax returns, cash flow projections, and the value of any collateral to secure the loan, based upon reports of independent appraisers and audits of accounts receivable or inventory pledged as security. In the case of real estate loans over a specified amount, the review of collateral value includes an appraisal report prepared by an independent, Bank-approved, appraiser.

Real Estate Loans. We offer commercial real estate loans to finance the acquisition of new or the refinancing of existing commercial properties, such as office buildings, industrial buildings, warehouses, hotels, shopping centers, automotive industry facilities and multiple dwellings. At December 31, 2016, real estate loans constituted 85% of our loan portfolio, of which 93% were commercial loans.

Commercial real estate loans typically have 10-year maturities with up to 25-year amortization of principal and interest and loan-to-value ratios of not more than 75% of the appraised value or purchase price, whichever is lower. We usually impose a prepayment penalty during the period within 3 to 5 years of the date of the loan.

Construction loans are comprised of loans on commercial, residential and income producing properties that generally have terms of 1 year, with options to extend for additional periods to complete construction and to accommodate the lease-up period. We usually require 15% equity capital investment by the developer and loan to value ratios of not more than 75% of anticipated completion value.

Miniperm loans finance the purchase and/or ownership of commercial properties, including owner-occupied and income producing properties. We also offer miniperm loans as take-out financing with our construction loans. Miniperm loans are generally made with an amortization schedule ranging from 20 to 25 years, with a lump sum balloon payment due in 3 to 5 years.

Equity lines of credit are revolving lines of credit collateralized by junior deeds of trust on residential real properties. They generally bear a rate of interest that floats with our base rate or the prime rate, and have maturities of 10 years.

We purchase participation interests in loans made by other financial institutions from time to time. These loans are subject to the same underwriting criteria and approval process as loans made directly by us.

Our real estate loans are typically collateralized by first or junior deeds of trust on specific commercial properties and equity lines of credit, and are subject to corporate or individual guarantees from financially capable parties, as available. The properties collateralizing real estate loans are principally located in our primary market areas of the California Central Valley and the Eastern Sierra. Real estate loans typically bear interest rates that float with an established index.

Our real estate portfolio is subject to certain risks, including (i) downturns in the California economy, (ii) significant interest rate fluctuations, (iii) reduction in real estate values in the California Central Valley, (iv) increased competition in pricing and loan structure, and (v) environmental risks, including natural disasters. As a result of the high concentration of the real estate loan in our loan portfolio, potential difficulties in the real estate markets could cause significant increases in nonperforming loans, which would reduce our profits. A decline in real estate values could cause some of our mortgage loans to become inadequately collateralized, which would expose us to a greater risk of loss. Additionally, a decline in real estate values could adversely affect our portfolio of commercial real estate loans and could result in a decline in the origination of such loans. However, we strive to reduce the exposure to such risks and seek to continue to maintain high quality in our real estate loans by (a) reviewing each loan request and each loan renewal individually, (b) using a dual signature approval system for the approval of each loan request for loans over a certain dollar amount, (c) adhering to written loan policies, including, among other factors, minimum collateral requirements, maximum loan-to-value ratio requirements, cash flow requirements and personal guarantees, (d) performing secondary appraisals from time to time, (e) conducting external independent credit review, and (f) conducting environmental reviews, where appropriate. We review each loan request on the basis of our ability to recover both principal and interest in view of the inherent risks. We monitor and stress test our entire portfolio, evaluating debt coverage ratios and loan-to-value ratios, on a quarterly basis. We monitor trends and evaluate exposure derived from simulated stressed market conditions. The portfolio is stratified by owner classification (either owner occupied or non-owner occupied), product type, geography and size.

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As of December 31, 2016, the aggregate loan-to-value of the entire commercial real estate portfolio was 46.8%. Historical data suggests that the Bank continues to maintain strong LTV, which has served as a cushion against precipitous reductions in real estate values. Non-owner occupied real estate comprises 40.8% of the Bank's total commitments, as of December 31, 2016. The loan-to-value on the non-owner occupied segment was 42.4%, as of December 31, 2016. The highest concentration by product type is office buildings, which comprised 25.5% of total CRE loan commitments outstanding, as of December 31, 2016.

Our portfolio diversity in terms of both product types and geographic distribution, combined with strong debt coverage ratios, a low aggregate loan-to-value and a high percentage of owner-occupied properties, significantly mitigate the risks associated with excessive commercial real estate concentration. These elements contribute strength to our overall real estate portfolio despite the current weakness in the real estate market.

Commercial Business Lending. We offer commercial loans to sole proprietorships, partnerships and corporations, with an emphasis on the real estate related industry. These commercial loans include business lines of credit and commercial term loans to finance operations, to provide working capital or for specific purposes, such as to finance the purchase of assets, equipment or inventory. Since a borrower's cash flow from operations is generally the primary source of repayment, our policies provide specific guidelines regarding required debt coverage and other important financial ratios.

Lines of credit are extended to businesses or individuals based on the financial strength and integrity of the borrower and are secured primarily by real estate, accounts receivable and inventory, and have a maturity of one year or less. Such lines of credit bear an interest rate that floats with the prime rate, LIBOR or another established index.

Commercial term loans are typically made to finance the acquisition of fixed assets, refinance short-term debts or to finance the purchase of businesses. Commercial term loans generally have terms from one to five years. They may be collateralized by the asset being acquired or other available assets and bear interest rates, which either floats with the prime rate, LIBOR or another established index or is fixed for the term of the loan.

Our portfolio of commercial loans is also subject to certain risks, including (i) downturns in the California economy, (ii) significant interest rate fluctuations; and (iii) the deterioration of a borrower's or guarantor's financial capabilities. We attempt to reduce the exposure to such risks through (a) reviewing each loan request and renewal individually, (b) requiring a dual signature approval system, (c) mandating strict adherence to written loan policies, and (d) performing external independent credit review. In addition, we monitor loans based on short-term asset values on a monthly or quarterly basis. In general, during the term of the relationship, we receive and review the financial statements of our borrowing customers on an ongoing basis, and we promptly respond to any deterioration that we note.

Small Business Administration Lending Services. Small Business Administration, or SBA, lending, forms an important part of our business. Our SBA lending service places an emphasis on minority-owned businesses. Our SBA market area includes the geographic areas encompassed by our full-service banking offices in the California Central Valley and in the Eastern Sierra. As an SBA lender, we enable borrowers to obtain SBA loans in order to acquire new businesses, expand existing businesses, and acquire locations in which to do business.

Consumer Loans. Consumer loans include personal loans, auto loans, home improvement loans, home mortgage loans, revolving lines of credit and other loans typically made by banks to individual borrowers. We provide consumer loan products in an effort to diversify our product line.

Our consumer loan portfolio is subject to certain risks, including:

amount of credit offered to consumers in the market,

interest rate increases, and

consumer bankruptcy laws which allow consumers to discharge certain debts.

We attempt to reduce the exposure to such risks through the direct approval of all consumer loans by:

reviewing each loan request and renewal individually,

using a dual signature system of approval,

strictly adhering to written credit policies and,

performing external independent credit review.

Deposit Activities and Other Sources of Funds

Our primary sources of funds are deposits and loan repayments. Scheduled loan repayments are a relatively stable source of funds, whereas deposit inflows, outflows and unscheduled loan prepayments (which are influenced significantly by general interest rate levels, interest rates available on other investments, competition, economic conditions and other factors) are not as stable. Customer deposits also remain a primary source of funds, but these balances may be influenced by adverse market changes in the industry. We may resort to other borrowings, on an as needed basis, as follows:

on a short-term basis to compensate for reductions in deposit inflows at less than projected levels, and

on a longer-term basis to support expanded lending activities and to match the maturity of repricing intervals of assets.

We offer a variety of accounts for depositors, which are designed to attract both short-term and long-term deposits. These accounts include certificates of deposit, or "CDs", regular savings accounts, money market accounts, checking and negotiable order of withdrawal, or "NOW", accounts, savings accounts, health savings accounts and individual retirement accounts, or "IRAs". These accounts generally earn interest at rates established by management based on competitive market factors and management's desire to increase or decrease certain types or maturities of deposits. As needs arise, we augment these customer deposits with brokered deposits. The more significant deposit accounts offered by us are described below:

Certificates of Deposit. We offer several types of CDs with a maximum maturity of five years. The substantial majority of our CDs have a maturity of one to twelve months and pay compounded interest typically credited monthly or at maturity.

Regular Savings Accounts. We offer savings accounts that allow for unlimited ATM and in-branch deposits and withdrawals. Interest is compounded daily and paid monthly.

Money Market Account. Money market accounts pay a variable interest rate that is tiered depending on the balance maintained in the account. Minimum opening balances vary. Interest is compounded daily and paid monthly.

Checking and NOW Accounts. Checking and NOW accounts are generally non-interest and interest bearing accounts, respectively, and may include service fees based on activity and balances. NOW accounts pay interest, but require a higher minimum balance to avoid service charges.

Federal Home Loan Bank Borrowings. To supplement our deposits as a source of funds for lending or investment, we borrow funds in the form of advances from the Federal Home Loan Bank. We regularly make use of Federal Home Loan Bank advances as part of our interest rate risk management, primarily to extend the duration of funding to match the longer term fixed rate loans held in the loan portfolio as part of our growth strategy.

As a member of the Federal Home Loan Bank system, we are required to invest in Federal Home Loan Bank stock based on a predetermined formula. Federal Home Loan Bank stock is a restricted investment security that can only be sold to other Federal Home Loan Bank members or redeemed by the Federal Home Loan Bank. As of December 31, 2016, we owned $3,037,000 in FHLB stock.

Advances from the Federal Home Loan Bank are typically secured by our entire real estate loan portfolio, which includes residential and commercial loans. At December 31, 2016, our borrowing limit with the Federal Home Loan Bank was approximately $237 million.

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Internet Banking

Since August 1, 2001, we have offered Internet banking services, which allows our customers to access their deposit accounts through the Internet. Customers are able to obtain transaction history and account information, transfer funds between accounts and make on-line bill payments. We intend to improve and develop our Internet banking products and delivery channels as the need arises and our resources permit.

Other Services

We also offer ATMs located at branch offices as well as four other ATMs at various off site locations, and customer access to an ATM network.

Marketing

Our marketing relies principally upon local advertising and promotional activity and upon personal contacts by our directors, officers and shareholders to attract business and to acquaint potential customers with our personalized services. We emphasize a high degree of personalized client service in order to be able to provide for each customer's banking needs. Our marketing approach emphasizes the advantages of dealing with an independent, locally managed and state chartered bank to meet the particular needs of consumers, professionals and business customers in the community. Our management continually evaluates all of our banking services with regard to their profitability and efforts and makes determinations based on these evaluations whether to continue or modify our business plan, where appropriate.

We do not currently have any plans to develop any new lines of business, which would require a material amount of capital investment on our part.

Competition

Regional Branch Competition. We consider our primary service area to be composed of the counties of San Joaquin, Stanislaus, Tuolumne, Inyo and Mono Counties, of California. The banking business in California generally, and in our primary service area, specifically, is competitive with respect to both loans and deposits and is dominated by a relatively small number of major banks which have many offices operating over wide geographic areas. These include Wells Fargo Bank, Bank of America, JP Morgan Chase Bank and Bank of the West. We compete for deposits and loans principally with these banks, as well as with savings and loan associations, thrift and loan associations, credit unions, mortgage companies, insurance companies, offerors of money market accounts and other lending institutions.

Among the advantages of these institutions are their ability to finance extensive advertising campaigns and to allocate their investment assets to regions of highest yield and demand, their ability to offer certain services, such as international banking and trust services which are not offered directly by the Company and, the ability by virtue of their greater total capitalization, to have substantially higher lending limits than we do. In addition, as a result of increased consolidation and the passage of interstate banking legislation there is and will continue to be increased competition among banks, savings and loan associations and credit unions for the deposit and loan business of individuals and businesses.

As of June 30, 2016, our primary service areas contained 173 banking offices, with approximately $14.8 billion in total deposits. As of June 30, 2016, we had total deposits of approximately $839 million, which represented approximately 5.7% of the total deposits in the Bank's primary service area. There can be no assurance that the Bank will maintain its competitive position against current and potential competitors, especially those with greater resources than the Bank. The four largest competing banks had 66 total branches and deposits averaged approximately $130 million per office as of June 30, 2016 within the Bank's primary service area.

In order to compete with major financial institutions in our primary service areas, we use to the fullest extent the flexibility that our independent status permits. This includes an emphasis on specialized services, local promotional activity, and personal contacts by our officers, directors and employees. In the event that there are customers whose needs exceed our lending limits, we may arrange for such loans on a participation basis with other financial institutions. We also assist customers who require other services that we do not offer by obtaining such services from correspondent banks. However, no assurance can be given that our continued efforts to compete with other financial institutions will be successful.

In addition to other banks, our competitors include savings institutions, credit unions, and numerous non-banking institutions, such as finance companies, leasing companies, insurance companies, brokerage firms, and investment banking firms. In recent years, increased competition has also developed from specialized finance and non-finance companies that offer money market and mutual funds, wholesale finance, credit card, and other consumer finance services, including on-line banking services and personal finance software. Strong competition for deposit and loan products affects the rates of those products as well as the terms on which they are offered to customers.

Other Competitive Factors. The more general competitive trends in the industry include increased consolidation and competition. Strong competitors, other than financial institutions, have entered banking markets with focused products targeted at highly profitable customer segments. Many of these competitors are able to compete across geographic boundaries and provide customers increasing access to meaningful alternatives to banking services in nearly all significant products areas. Mergers between financial institutions have placed additional pressure on banks within the industry to streamline their operations, reduce expenses, and increase revenues to remain competitive. Competition has also intensified due to the federal and state interstate banking laws, which permit banking organizations to expand geographically, and the California market has been particularly attractive to out-of-state institutions. The Financial Modernization Act, which has made it possible for full affiliations to occur between banks and securities firms, insurance companies, and other financial companies, is also expected to intensify competitive conditions.

Technological innovations have also resulted in increased competition in the financial services industry. Such innovations have, for example, made it possible for non-depository institutions to offer customers automated transfer payment services that were previously considered traditional banking products. In addition, many customers now expect a choice of several delivery systems and channels, including telephone, mail, home computer, mobile devices, ATMs, self-service branches and/or in-store branches.

Business Concentration. No individual or single group of related accounts is considered material in relation to our total assets or deposits, or in relation to our overall business. However, approximately 85% of our loan portfolio held for investment at December 31, 2016 consisted of real estate-related loans, including construction loans, miniperm loans, real estate mortgage loans and commercial loans secured by real estate. Moreover, our business activities are currently focused primarily in Central California, with the majority of our business concentrated in San Joaquin, Stanislaus, Tuolumne, Inyo and Mono Counties. Consequently, our results of operations and financial condition are dependent upon the general trends in the Central California economies and, in particular, the residential and commercial real estate markets. In addition, the concentration of our operations in Central California exposes us to greater risk than other banking companies with a wider geographic base in the event of catastrophes, such as earthquakes, fires and floods in this region.

Employees

As of December 31, 2016, we had 169 employees (139 full-time employees and 30 part-time employees). None of our employees are currently represented by a union or covered by a collective bargaining agreement.

Economic Conditions and Legislative and Regulatory Developments

As it is the case with financial institutions with our size and scope, our profitability primarily depends on interest rate differentials. Interest rates are highly sensitive to many factors that are beyond our control and cannot be predicted, such as inflation, recession and unemployment, and the impact that future changes in domestic and foreign economic conditions might have on the Company. A more detailed discussion of the Company’s interest rate risks and the mitigation of those risks is included in Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations, in this Annual Report on Form 10-K.

Our business is also influenced by the monetary and fiscal policies of the Federal government and the policies of regulatory agencies. The Federal Reserve Board implements national monetary policies (with objectives such as maintaining price stability, stimulating growth and reducing unemployment) through its open-market operations in U.S. Government securities, by adjusting the required level of reserves for depository institutions subject to its reserve requirements, and by varying the target Federal funds and discount rates applicable to borrowings by depository institutions. The actions of the Federal Reserve Board in these areas influence the growth of bank loans, investments, and deposits and also affect interest earned on interest-earning assets and interest paid on interest-bearing liabilities. The nature and impact of any future changes in monetary and fiscal policies on us cannot be predicted.

From time to time, federal and state legislation is enacted that may have the effect of materially increasing the cost of doing business, limiting or expanding permissible activities, or affecting the competitive balance between banks and other financial services providers. In response to the economic downturn and financial industry instability, legislative and regulatory initiatives were, and are expected to continue to be, introduced and implemented, which substantially intensify the regulation of the financial services industry. Moreover, in light of the economic environment over the last three to five years, bank regulatory agencies have responded to concerns and trends identified in examinations. While their response resulted in the increased issuance and continuation of enforcement actions against financial institutions towards the end of the last decade and into the beginning of this decade, the level of such actions compared to the peak in 2010 has decreased.

Supervision and Regulation in General

The banking and financial services business in which we engage is highly regulated. Such regulation is intended, among other things, to protect depositors insured by the FDIC and the entire banking system. These regulations affect our lending practices, consumer protections, capital structure, investment practices and dividend policy.

The Company is a legal entity separate and distinct from the Bank. The Company and the Bank are each subject to supervision and regulation by a number of federal and state agencies and regulatory bodies, as outlined below.

Upon effectiveness of the bank holding company reorganization on July 2, 2008, the Company became subject to regulation under the Bank Holding Company Act of 1956, as amended (“BHCA”). As a bank holding company, the Company is regulated and is subject to inspection, examination and supervision by the Federal Reserve Board. It is also subject to the California Financial Code, as well as limited oversight by the DBO and the FDIC. Under the Federal Reserve Board’s regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks. The BHCA regulates the activities of holding companies including acquisitions, mergers, and consolidations and, together with the Gramm-Leach Bliley Act of 1999, the scope of allowable banking activities.

As a California-state chartered bank, the Bank is subject to primary supervision, examination and regulation by the DBO and the Federal Reserve Board. The Federal Reserve Board is the primary federal regulator of state member banks. The Bank is also subject to regulation by the FDIC, which insures the Bank’s deposits as permitted by law. If, as a result of an examination of a bank, the Federal Reserve Board determines that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of its operations are unsatisfactory, or that it or its management is violating or has violated any law or regulation, various remedies are available to the Federal Reserve Board. Such remedies include the power to: enjoin “unsafe or unsound” practices; require affirmative action to correct any conditions resulting from any violation or practice; issue an administrative order that can be judicially enforced; direct an increase in capital; restrict growth; assess civil monetary penalties; remove officers and directors; institute a receivership; and, ultimately terminate the bank’s deposit insurance, which would result in a revocation of its charter. The DBO separately holds many of the same remedial powers.

The commercial banking business is also influenced by the monetary and fiscal policies of the federal government and the policies of the Board of Governors of the Federal Reserve System, also known as the FRB or the Federal Reserve Board. As a member of the Federal Reserve System, we are subject to certain regulations of the Board of Governors of the Federal Reserve System. The regulations of these agencies govern most aspects of our business, including the filing of periodic reports, and activities relating to dividends, investments, loans, borrowings, capital requirements, certain check-clearing activities, branching, mergers and acquisitions, reserves against deposits, and numerous other areas. Supervision, legal action and examination of us by the FRB is generally intended to protect depositors and is not intended for the protection of our shareholders. The Federal Reserve Board implements national monetary policies (with objectives such as curbing inflation and combating recession) by its open-market operations in United States Government securities, by adjusting the required level of reserves for financial intermediaries subject to its reserve requirements and by varying the discount rates applicable to borrowings by depository institutions. The actions of the Federal Reserve Board in these areas influence the growth of bank loans, investments and deposits and affects interest rates charged on loans and paid on deposits. Indirectly such actions may also impact the ability of non-bank financial institutions to compete with us. The nature and impact of any future changes in monetary policies cannot be predicted.

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

The federal and state bank regulatory agencies may respond to concerns and trends identified in examinations by issuing enforcement actions to, and entering into cease and desist orders, consent orders and memoranda of understanding with, financial institutions requiring action by management and boards of directors to address credit quality, liquidity, risk management and capital adequacy concerns, as well as other safety and soundness or compliance issues. Banks and bank holding companies are also subject to examination and potential enforcement actions by their state regulatory agencies.

Bank Holding Company and Bank Regulation

Bank holding companies and their subsidiaries are subject to significant regulation and restrictions by Federal and State laws and regulatory agencies. Federal and State laws, regulations and restrictions, which may affect the cost of doing business, limit permissible activities and expansion or impact the competitive balance between banks and other financial services providers, are intended primarily for the protection of depositors and the FDIC deposit insurance fund (“DIF”), and secondarily for the stability of the U.S. banking system. They are not intended for the benefit of shareholders of financial institutions. The following discussion of key statutes and regulations to which the Company and the Bank are subject is a summary and does not purport to be complete nor does it address all applicable statutes and regulations. This discussion is qualified in its entirety by reference to the statutes and regulations referred to in this discussion.

The wide range of requirements and restrictions contained in both Federal and State banking laws include:

Requirements that bank holding companies serve as a source of strength for their banking subsidiaries. In addition, the regulatory agencies have “prompt corrective action” authority to limit activities and order an assessment of a bank holding company if the capital of a bank subsidiary falls below capital levels required by the regulators.

Limitations on dividends payable to shareholders. A substantial portion of the Company’s funds to pay dividends or to pay principal and interest on our debt obligations is derived from dividends paid by the Bank. The Company’s and the Bank’s ability to pay dividends is subject to legal and regulatory restrictions. The Federal Reserve Board has authority to prohibit bank holding companies from paying dividends if such payment is deemed to be an unsafe or unsound practice.

Limitations on dividends payable by bank subsidiaries. These dividends are subject to various legal and regulatory restrictions. The federal banking agencies have indicated that paying dividends that deplete a depositary institution’s capital base to an inadequate level would be an unsafe and unsound banking practice. Moreover, the federal agencies have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings.

Safety and soundness requirements. Banks must be operated in a safe and sound manner and meet standards applicable to internal controls, information systems, internal audit, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, as well as other operational and management standards. These safety and soundness requirements give bank regulatory agencies significant latitude in exercising their supervisory authority and their authority to initiate informal or formal enforcement action.

Requirements for approval of acquisitions and activities. Prior approval or non-objection of the applicable federal regulatory agencies is required for most acquisitions and mergers and in order to engage in certain non-banking activities and activities that have been determined by the Federal Reserve to be financial in nature, incidental to financial activities, or complementary to a financial activity. Laws and regulations governing state-chartered banks contain similar provisions concerning acquisitions and activities.

The Community Reinvestment Act (the "CRA"). The CRA requires that banks help meet the credit needs in their communities, including the availability of credit to low and moderate income individuals. If the Company or the Bank fails to adequately serve their communities, penalties may be imposed, including denials of applications for branches, to add subsidiaries and affiliates, or to merge with or purchase other financial institutions.

The Bank Secrecy Act, the USA Patriot Act, and other anti-money laundering laws. These laws and regulations require financial institutions to assist U.S. Government agencies in detecting and preventing money laundering and other illegal acts by maintaining policies, procedures and controls designed to detect and report money laundering, terrorist financing, and other suspicious activity.

Limitations on the amount of loans to one borrower and its affiliates and to executive officers and directors.

Limitations on transactions with affiliates.

Restrictions on the nature and amount of any investments in, and ability to underwrite certain securities.

Requirements for opening of branches intra- and interstate.

Fair lending and truth in lending laws to ensure equal access to credit and to protect consumers in credit transactions.

Provisions of the Gramm-Leach-Bliley Act of 1999 ("GLB Act") and other federal and state laws dealing with privacy for nonpublic personal information of customers.

The following discussion summarizes certain significant laws, rules and regulations affecting both the Company and the Bank. The Bank addresses the many state and federal regulations it is subject to through a comprehensive compliance program that addresses the various risks associated with these issues. The following discussion is not meant to cover all applicable rules and regulations and it is qualified in its entirety by reference to such laws, rules and regulations which may change from time to time.

The Dodd-Frank Wall Street Reform and Consumer Protection Act

The events of the past several years have led to numerous new laws and regulatory pronouncements in the United States and internationally for financial institutions. The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), enacted in 2010, is one of the most far reaching legislative actions affecting the financial services industry in decades and significantly restructures the financial regulatory regime in the United States.

The Dodd-Frank Act broadly affects the financial services industry by creating new resolution authorities, requiring ongoing stress testing of capital, mandating higher capital and liquidity requirements, increasing regulation of executive and incentive-based compensation and requiring numerous other provisions aimed at strengthening the sound operation of the financial services sector depending, in part, on the size of the financial institution. Among other things, the Dodd-Frank Act provides for:

capital standards applicable to bank holding companies may be no less stringent than those applied to insured depository institutions;

annual stress tests and early remediation or so-called living wills are required for larger banks with more than $50 billion of assets as well risk committees of their boards of directors that include a risk expert and such requirements may have the effect of establishing new best practices standards for smaller banks;

trust preferred securities must generally be deducted from Tier 1 capital over a three-year phase-in period which ended in 2016, although depository institution holding companies with assets of less than $15 billion as of year-end 2009 were grandfathered with respect to such securities for purposes of calculating regulatory capital;

the assessment base for federal deposit insurance was changed to consolidated assets less tangible capital instead of the amount of insured deposits, which generally increased the insurance fees of larger banks, but had relatively less impact on smaller banks;

repeal of the federal prohibition on the payment of interest on demand deposits, including business checking accounts, and made permanent the $250,000 limit for federal deposit insurance;

- the establishment of the Consumer Finance Protection Bureau (the "CFPB") with responsibility for promulgating regulations designed to protect consumers' financial interests and prohibit unfair, deceptive and abusive acts and practices by financial institutions, and with authority to directly examine those financial institutions with $10 billion or more in assets for compliance with the regulations promulgated by the CFPB;

- limits, or places significant burdens and compliance and other costs, on activities traditionally conducted by banking organizations, such as originating and securitizing mortgage loans and other financial assets, arranging and participating in swap and derivative transactions, proprietary trading and investing in private equity and other funds; and

- the establishment of new compensation restrictions and standards regarding the time, manner and form of compensation given to key executives and other personnel receiving incentive compensation, including documentation and governance, proxy access by stockholders, deferral and claw-back requirements.

As required by the Dodd-Frank Act, federal regulators have adopted regulations to (i) increase capital requirements on banks and bank holding companies pursuant to Basel III, and (ii) implement the so-called "Volcker Rule" of the Dodd-Frank Act, which significantly restricts certain activities by covered bank holding companies, including restrictions on proprietary trading and private equity investing.

Many of the regulations to implement the Dodd-Frank Act have not yet been published for comment or adopted in final form and a number of the regulations that have been adopted in final form will take effect over several years, making it difficult to anticipate the overall financial impact on the Company and the Bank, our customers or the financial industry more generally. Individually and collectively, these regulations resulting from the Dodd-Frank Act may materially and adversely affect the Company’s and the Bank’s business, financial condition, and results of operations. Provisions in the legislation that require revisions to the capital requirements of the Company and the Bank could require the Company and the Bank to seek additional sources of capital in the future.

Volcker Rule

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

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

The compliance requirements under the final rules vary based on the size of the banking entity and the scope of activities conducted. Banking entities with significant trading operations will be required to establish a detailed compliance program and their CEOs will be required to attest that the program is reasonably designed to achieve compliance with the final rule. Independent testing and analysis of an institution’s compliance program will also be required. The final rules reduce the burden on smaller, less-complex institutions by limiting their compliance and reporting requirements. Additionally, a banking entity that does not engage in covered trading activities will not need to establish a compliance program. The Company and the Bank held no investment positions at December 31, 2016 or 2015 that were subject to the final rule. Therefore, while these new rules may require us to conduct certain internal analysis and reporting, we believe that they will not require any material changes in our operations or business.

Capital Adequacy Requirements

Banks and bank holding companies are subject to various capital requirements administered by state and federal banking agencies. Capital adequacy guidelines involve quantitative measures of assets, liabilities and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting and other factors.

The federal banking agencies have adopted risk-based minimum capital guidelines intended to provide a measure of capital that reflects the degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets and transactions which are recorded as off balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off balance sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as federal banking agencies, to 100% for assets with relatively high credit risk. The higher the category, the more risk a bank is subject to and thus the more capital that is required.

The regulatory agencies' risk-based capital guidelines are based upon capital accords of the internal Basel Committee on Bank Supervision ("Basel Committee"), a committee of central banks and bank supervisors/regulators from the major industrialized countries that develops broad policy guidelines, which each country's supervisors can use to determine the supervisory policies they apply to their home jurisdiction. In December 2010, the Basel Committee released its final framework for strengthening international capital and liquidity regulation, now officially identified as "Basel III." Basel III, when fully phased-in, would require bank holding companies and their bank subsidiaries to maintain substantially more capital than currently required, with a greater emphasis on common equity. The Basel III capital framework, among other things:

- introduces as a new capital measure, Common Equity Tier 1 ("CET1"), more commonly known in the United States as "Tier 1 Common," and defines CET1 narrowly by requiring that most adjustments to regulatory capital measures be made to CET1 and not to the other components of capital, and expands the scope of the adjustments as compared to existing regulations;

- when fully phased in, requires banks to maintain: (i) a newly adopted international standard, a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%); (ii) an additional "SIFI buffer" for those large institutions deemed to be systemically important, ranging from 1.0% to 2.5%, and up to 3.5% under certain conditions; (iii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation); (iv) a minimum ratio of Total (that is, Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation); and (v) as a newly adopted international standard, a minimum leverage ratio of 3%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (as the average for each quarter of the month-end ratios for the quarter); and

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- an additional “countercyclical capital buffer,” generally to be imposed when national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk, that would be a CET1 add-on to the capital conservation buffer in the range of 0% to 2.5% when fully implemented.

In July 2014, the U.S. banking agencies approved the U.S. version of Basel III. The federal bank regulatory agencies adopted version of Basel III revises the risk-based and leverage capital requirements and the method for calculating risk-weighted assets to make them consistent with Basel III and to meet the requirements of the Dodd-Frank Act. Although many of the rules contained in these final regulations are applicable only to large, internationally active banks, some of them will apply on a phased in basis to all banking organizations, including the Company and the Bank. Among other things, the rules establish a new minimum common equity Tier 1 ratio (4.5% of risk-weighted assets), a higher minimum Tier 1 risk-based capital requirement (6.0% of risk-weighted assets) and a minimum non-risk-based leverage ratio (4.00% eliminating a 3.00% exception for higher rated banks). The new additional capital conservation buffer of 2.5% of risk weighted assets over each of the required capital ratios will be phased in from 2016 to 2019 and must be met to avoid limitations on the ability of the Bank to pay dividends, repurchase shares or pay discretionary bonuses. The additional “countercyclical capital buffer” is also required for larger and more complex institutions. The new rules assign higher risk weighting to exposures that are more than 90 days past due or are on nonaccrual status and certain commercial real estate facilities that finance the acquisition, development or construction of real property. The rules also change the permitted composition of Tier 1 capital to exclude trust preferred securities, mortgage servicing rights and certain deferred tax assets and include unrealized gains and losses on available for sale debt and equity securities (with a one-time opt out option for Standardized Banks (banks with less than $250 billion of total consolidated assets and less than $10 billion of foreign exposures)). The rules, including alternative requirements for smaller community financial institutions like the Company, would be phased in through 2019. The implementation of the Basel III framework for the Company and the Bank commenced on January 1, 2015.

The Bank is well capitalized. As of December 31, 2016 and 2015, the Bank’s Total Risk-Based Capital Ratio was 11.3% and 12.1%, Tier 1 Risk-Based Capital Ratio was 10.2% and 10.9%, and our Common Equity Tier 1 Risk-Based Capital Ratio was 10.2% and 10.9%, respectively.

In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to total average assets, referred to as the leverage ratio. Banks that have received the highest rating of the five categories used by regulators to rate banks and are not anticipating or experiencing any significant growth must maintain a ratio of Tier 1 capital (net of all intangibles) to adjusted total assets, or “Leverage Capital Ratio”, of at least 3%. All other institutions are required to maintain a leverage ratio of at least 100 to 200 basis points above the 3% minimum, for a minimum of 4% to 5%. Pursuant to federal regulations, banks must maintain capital levels commensurate with the level of risk to which they are exposed, including the volume and severity of problem loans. As of December 31, 2016 and 2015, the Bank’s Leverage Capital Ratios were 8.1% and 9.0%, respectively.

Federal banking regulators may set capital requirements higher than the minimums described above for financial institutions whose circumstances warrant it. For example, a financial institution experiencing or anticipating significant growth may be expected to maintain capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets.

A bank may be treated as though it were in the next lower capital category if, after notice and the opportunity for a hearing, the appropriate federal agency finds an unsafe or unsound condition or practice so warrants, but no bank may be treated as “critically undercapitalized” unless its actual capital ratio warrants such treatment.

At each successively lower capital category, an insured bank is subject to increased restrictions on its operations. For example, a bank is generally prohibited from paying management fees to any controlling persons or from making capital distributions, if to do so would make the Bank “undercapitalized.” Asset growth and branching restrictions apply to undercapitalized banks, which are required to submit written capital restoration plans meeting specified requirements (including a guarantee by the parent holding company, if any). “Significantly undercapitalized” banks are subject to broad regulatory authority, including among other things, capital directives, forced mergers, restrictions on the rates of interest they may pay on deposits, restrictions on asset growth and activities, and prohibitions on paying certain bonuses without FRB approval. Even more severe restrictions apply to critically undercapitalized banks. Most importantly, except under limited circumstances, the appropriate federal banking agency is required to appoint a conservator or receiver for an insured bank not later than 90 days after the Bank becomes critically undercapitalized.

In addition to measures taken under the prompt corrective action provisions, insured banks may be subject to potential actions by federal regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation or any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include the issuance of cease and desist orders, termination of insurance of deposits (in the case of a bank), the imposition of civil money penalties, the issuance of directives to increase capital, formal and informal agreements, or removal and prohibition orders against "institution-affiliated" parties.

Dividends

The payment of cash dividends by the Bank to the Company is subject to restrictions set forth in the California Financial Code (the "Code"). Prior to any distribution from the Bank to the Company, a calculation is made to ensure compliance with the provisions of the Code and to ensure that the Bank remains within capital guidelines set forth by the DBO and the FRB. In the event that the intended distribution from the Bank to the Company exceeds the restriction in the Code, advance approval from FRB is required. Management anticipates that there will be sufficient earnings at the Bank level to provide dividends to the Company to meet its cash requirements for 2017.

Safety and Soundness Standards

Federal banking agencies have also adopted guidelines establishing safety and soundness standards for all insured depository institutions. Those guidelines relate to internal controls, information systems, internal audit systems, loan underwriting and documentation, compensation and interest rate exposure. In general, the standards are designed to assist the federal banking agencies in identifying and addressing problems at insured depository institutions before capital becomes impaired. If an institution fails to meet these standards, the appropriate federal banking agency may require the institution to submit a compliance plan and institute enforcement proceedings, if an acceptable compliance plan is not submitted.

Deposit Insurance and FDIC Insurance Assessments

Our deposits are insured by the FDIC to the maximum amount permitted by law, which is currently $250,000 per depositor. The Dodd-Frank Act made the deposit insurance coverage permanent at the $250,000 level retroactive to

January 1, 2008.

On February 7, 2011, as required by the Dodd-Frank Act, the FDIC approved a rule that changes the FDIC insurance assessment base from adjusted domestic deposits to a bank’s average consolidated total assets minus average tangible equity, defined as Tier 1 capital. Since the new base is larger than the current base, the new rule lowers assessment rates to between 2.5 and 9 basis points on the broader base for banks in the lowest risk category, and 30 to 45 basis points for banks in the highest risk category. The change was effective beginning with the second quarter of 2011. Since we have a solid core deposit base and do not rely heavily on borrowings and brokered deposits, the benefit of the lower assessment rate (which has dropped by approximately half for us) significantly outweighed the effect of a wider assessment base.

Community Reinvestment Act

We are subject to certain requirements and reporting obligations involving the Community Reinvestment Act, or “CRA”. The CRA generally requires federal banking agencies to evaluate the record of financial institutions in meeting the credit needs of local communities, including low and moderate-income neighborhoods. The CRA further requires that a record be kept of whether a financial institution meets its community credit needs, which record will be taken into account when evaluating applications for, among other things, domestic branches, consummating mergers or acquisitions, or holding company formations. In measuring a bank’s compliance with its CRA obligations, the regulators now utilize a performance-based evaluation system, which bases CRA ratings on the Company’s actual lending service and investment performance, rather than on the extent to which the institution conducts needs assessments, documents community outreach activities or complies with other procedural requirements. In connection with its assessment of CRA performance, the FRB assigns a rating of “outstanding,” “satisfactory,” “needs to improve” or “substantial noncompliance.” Our CRA performance is evaluated by the FRB under the intermediate small bank requirements. The FRB’s last CRA performance examination was performed on us and completed in July of 2013 and we received an overall “Satisfactory” CRA Assessment Rating.

Anti-Money Laundering Regulations

A series of banking laws and regulations beginning with the Bank Secrecy Act in 1970 require banks to prevent, detect, and report illicit or illegal financial activities to the federal government to prevent money laundering, international drug trafficking, and terrorism. Under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and “know your customer” standards in their dealings with high risk customers, foreign financial institutions, and foreign individuals and entities. We have extensive controls to comply with these requirements.

Privacy and Data Security

The Gramm-Leach Bliley Act (“GLBA”) of 1999 imposed requirements on financial institutions with respect to consumer privacy. The GLBA generally prohibits disclosure of consumer information to non-affiliated third parties unless the consumer has been given the opportunity to object and has not objected to such disclosure. Financial institutions are further required to disclose their privacy policies to consumers annually. The GLBA also directs federal regulators to prescribe standards for the security of consumer information. We are subject to such standards, as well as standards for notifying consumers in the event of a security breach. We must disclose our privacy policy to consumers and permit consumers to “opt out” of having certain personal financial information disclosed to unaffiliated third parties. We are required to have an information security program to safeguard the confidentiality and security of customer information and to ensure proper disposal. Customers must be notified when unauthorized disclosure involves sensitive customer information that may be misused.

Other Consumer Protection Laws and Regulations

Bank regulatory agencies are increasingly focusing on compliance with consumer protection laws and regulations.

Interest and other charges collected or contracted for by the Bank are subject to state usury laws and federal laws concerning interest rates. The Bank’s operations are also subject to federal laws applicable to credit transactions, and consumer protection statutes and regulations, such as the:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Home Mortgage Disclosure Act, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act, governing the use and provision of information to credit reporting agencies;
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;
- Truth in Savings Act; and
- rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

The operations of the Bank are also subject to the:

- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Electronic Funds Transfer Act and Regulation E promulgated thereunder, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services;
- Check Clearing for the 21st Century Act (also known as "Check 21"), which gives "substitute checks," such as digital check images and copies made from that image, the same legal standing as the original paper check; and
- The USA PATRIOT Act, which requires financial institutions to, among other things, establish broadened anti-money laundering compliance programs, and due diligence policies and controls to ensure the detection and reporting of money laundering. Such required compliance programs are intended to supplement existing compliance requirements that also apply to financial institutions under the Bank Secrecy Act and the Office of Foreign Assets Control regulations.

Due to heightened regulatory concern related to compliance with consumer protection laws and regulations generally, we may incur additional compliance costs or be required to expend additional funds for investments in the local communities we serve.

Restriction on Transactions between Member Banks and their Affiliates

Transactions between the Company and the Bank are quantitatively and qualitatively restricted under Sections 23A and 23B of the Federal Reserve Act and Federal Reserve Regulation W. Section 23A places restrictions on the Bank's "covered transactions" with the Company, including loans and other extensions of credit, investments in the securities of, and purchases of assets from the Company. Section 23B requires that certain transactions, including all covered transactions, be on market terms and conditions. Federal Reserve Regulation W combines statutory restrictions on transactions between the Bank and the Company with FRB interpretations in an effort to simplify compliance with Sections 23A and 23B.

The Sarbanes-Oxley Act of 2002

On July 30, 2002, President Bush signed into law The Sarbanes-Oxley Act of 2002, or "Sarbanes-Oxley Act". The Sarbanes-Oxley Act addresses accounting oversight and corporate governance matters relating to the operations of public companies. During 2003, the Commission issued a number of regulations under the directive of the Sarbanes-Oxley Act significantly increasing public company governance-related obligations and filing requirements, including:

the establishment of an independent public oversight of public company accounting firms by a board that will set auditing, quality and ethical standards for and have investigative and disciplinary powers over such accounting firms,

the enhanced regulation of the independence, responsibilities and conduct of accounting firms which provide auditing services to public companies,

the increase of penalties for fraud related crimes, the enhanced disclosure, certification, and monitoring of financial statements, internal financial controls and the audit process, and

the enhanced and accelerated reporting of corporate disclosures and internal governance.

Furthermore, in November 2003, in response to the directives of the Sarbanes-Oxley Act, NASDAQ adopted substantially expanded corporate governance criteria for the issuers of securities quoted on the NASDAQ markets. The new NASDAQ rules govern, among other things, the enhancement and regulation of corporate disclosure and internal governance of listed companies and of the authority, role and responsibilities of their boards of directors and, in particular, of “independent” members of such boards of directors, in the areas of nominations, corporate governance, compensation and the monitoring of the audit and internal financial control processes.

The Sarbanes-Oxley Act, the Commission rules promulgated thereunder, and the new NASDAQ governance requirements have required the Company to review its current procedures and policies to determine whether they comply with the new legislation and its implementing regulations. The Company is primarily responsible for ensuring compliance with Sarbanes-Oxley and the NASDAQ governance rules, as applicable.

Securities Laws and Corporate Governance

The Company is subject to the disclosure and regulatory requirements of the 1933 Act and the 1934 Act, both as administered by the SEC. As a company listed on the NASDAQ Global Select Market, the Company is subject to NASDAQ listing standards for listed companies.

As discussed above, we are also subject to the Sarbanes-Oxley Act of 2002, provisions of the Dodd-Frank Act, and other federal and state laws and regulations which address, among other issues, required executive certification of financial presentations, corporate governance requirements for board audit committees and their members, and disclosure of controls and procedures and internal control over financial reporting, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. NASDAQ has also adopted corporate governance rules, which are intended to allow shareholders and investors to more easily and efficiently monitor the performance of companies and their directors.

Finally, the Company is subject to the provisions of the California General Corporation Law, while the Bank is also subject to the California Financial Code provisions.

Environmental Regulations

In the course of our business, we may foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, as the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we ever become subject to significant environmental liabilities, our business, financial condition, liquidity and results of operations could be materially and adversely affected.

Other Pending and Proposed Legislation

Other legislative and regulatory initiatives which could affect us and the banking industry, in general, are pending and additional initiatives may be proposed or introduced before the United States Congress, the California legislature and other governmental bodies in the future. Such proposals, if enacted, may further alter the structure, regulation and competitive relationship among financial institutions, and may subject us to increased regulation, disclosure and reporting requirements. In addition, the various banking regulatory agencies often adopt new rules and regulations to implement and enforce existing legislation. We cannot predict whether, or in what form, any such legislation or regulations may be enacted or the extent to which our business would be affected thereby.

Available Information

The Company maintains an Internet website at http://www.ovcb.com. The Company makes available its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the 1934 Act and other information related to the Company free of charge, through this site as soon as reasonably practicable after it electronically files those documents with, or otherwise furnishes them to, the SEC. The Company's website also contains its Committee Charters, Code of Ethics, Code of Conduct and Corporate Governance Guidelines. The Company's internet website and the information contained therein or connected thereto are not intended to be incorporated into this annual report on Form 10-K.

In addition, copies of our filings are available by requesting them in writing or by phone from:

Corporate Secretary

Oak Valley Bancorp

125 North Third Avenue
Oakdale, California

209-844-7578

ITEM 1A. RISK FACTORS

Not applicable.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our main office is located in a complex at 125 North Third Avenue, Oakdale, CA 95361, in downtown Oakdale and houses our primary loan production, operations, and administrative offices. The building has an automated teller machine and onsite parking. The Company's Oakdale complex includes the adjacent corporate headquarter building and occupies approximately 20,000 square feet of space.

Property Location and Address	Square Footage	Lease Expiration Date	Lease Extension Options
Oakdale, 125 N. 3rd Ave.	9,600	n/a*	n/a*
Oakdale, 338 F Street	9,860	n/a*	n/a*
Sonora, 14580 Mono Way	2,500	4/2018	two, 5-year term extensions
Modesto, 12th & I Street	4,500	3/2021	one, 5-year term extensions
Bridgeport, 166 Main Street	2,875	n/a*	n/a*
Mammoth Lakes, 307 Old Mammoth Road	1,856	n/a*	n/a*
Bishop, 351 North Main Street	3,680	8/2019	one, 5-year term extensions
Modesto, 4120 Dale Road	4,500	3/2021	one, 5-year term extensions
Turlock, 2001 Geer Road	2,400	1/2020	one, 5-year term extensions
Patterson, 20 Plaza Circle	2,100	n/a*	n/a*
Escalon, 1910 McHenry Ave.	3,500	4/2021	two, 5-year term extensions
Ripon, 150 North Wilma Ave.	1,800	12/2020	No remaining extensions
Stockton, 2935 West March Lane	8,000	12/2022	two, 5-year term extensions
Modesto, 3508 McHenry Ave.	5,400	n/a*	n/a*
Manteca, 191 W. North St.	2,800	5/2021	one, 5-year term extensions
Tracy, 1034 N. Central Ave.	5,000	7/2024	two, 5-year term extensions
Sonora, 85 Mono Way	4,000	12/2030	two, 5-year term extensions

* The Company owns this property.

Management has determined that all of its premises are adequate for its present and anticipated level of business.

ITEM 3. LEGAL PROCEEDINGS

From time to time, the Company is a party to claims and legal proceedings arising in the ordinary course of business. Our management evaluates its exposure to these claims and proceedings individually and in the aggregate and provides for potential losses on such litigation if the amount of the loss is estimable and the loss is probable.

To our knowledge, there are no material litigation matters pending at the current time. Although the results of any such litigation matters and claims cannot be predicted with certainty, we believe that the final outcome of any such claims and proceedings will not have a material adverse impact on the Company's financial position, liquidity, or results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

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

Price Range of Common Stock

Our common stock is traded on the NASDAQ Capital Market under the symbol "OVLY." The following table sets forth the high and low sales prices of our common stock, based on inter-dealer prices that do not include retail markups, markdowns or commissions, and cash dividends declared for the two calendar years ended December 31, 2016 and 2015, respectively. From time to time, during the periods indicated, trading activity in our common stock was infrequent. The source of the quotes is The NASDAQ Stock Market, LLC.

	Common Stock Sale Price	
For Calendar Quarter Ended	**High**	**Low**
March 31, 2015	$11.75	$8.87
June 30, 2015	$10.50	$8.99
September 30, 2015	$10.40	$9.29
December 31, 2015	$11.35	$9.26
March 31, 2016	$10.40	$9.22
June 30, 2016	$9.97	$9.32
September 30, 2016	$10.37	$9.35
December 31, 2016	$12.75	$10.25

On March 7, 2017, the closing price of our common stock was $14.50 per share; and there were approximately 404 shareholders of record of the common stock and 8,086,205 outstanding shares of common stock. The actual number of shareholders is greater than this number of record holders and includes shareholders who are beneficial owners but whose shares are held in street name by brokers and other nominees.

Dividends

Our ability to pay any cash dividends will depend not only upon our earnings during a specified period, but also on our meeting certain capital requirements.

Dividends the Company declares are subject to the restrictions set forth in the California General Corporation Law (the “Corporation Law”). The Corporation Law provides that a corporation may make a distribution to its shareholders if the corporation’s retained earnings equal at least the amount of the proposed distribution. The Corporation Law also provides that, in the event that sufficient retained earnings are not available for the proposed distribution, a corporation may nevertheless make a distribution to its shareholders if it meets two conditions, which generally stated are as follows: (i) the corporation’s assets equal at least 1 and 1/4 times its liabilities, and (ii) the corporation’s current assets equal at least its current liabilities or, if the average of the corporation’s earnings before taxes on income and before interest expenses for the two preceding fiscal years was less than the average of the corporation’s interest expenses for such fiscal years, then the corporation’s current assets must equal at least 1 and 1/4 times its current liabilities.

Additionally, the Federal Reserve Board has authority to limit the payment of dividends by bank holding companies, such as the Company, in certain circumstances, requiring, among other things, a holding company to consult with the Federal Reserve Board prior to payment of a dividend if the company does not have sufficient recent earnings in excess of the proposed dividend.

The principal source of funds from which the Company may pay dividends is the receipt of dividends from the Bank. The availability of dividends from the Bank is limited by various statutes and regulations. The Bank is subject first to corporate restrictions on its ability to pay dividends. Further, the Bank may not pay a dividend if it would be undercapitalized after the dividend payment is made. The payment of cash dividends by the Bank is subject to restrictions set forth in the California Financial Code (the “Financial Code”). The Financial Code provides that a bank may not make a cash distribution to its shareholders in excess of the lesser of (a) bank’s retained earnings; or (b) bank’s net income for its last three fiscal years, less the amount of any distributions made by the bank or by any majority-owned subsidiary of the bank to the shareholders of the bank during such period. However, a bank may, with the approval of the DBO, make a distribution to its shareholders in an amount not exceeding the greatest of (a) its retained earnings; (b) its net income for its last fiscal year; or (c) its net income for its current fiscal year. In the event that the DBO determines that the shareholders’ equity of a bank is inadequate or that the making of a distribution by the bank would be unsafe or unsound, the DBO may order the bank to refrain from making a proposed distribution. The FDIC may also restrict the payment of dividends if such payment would be deemed unsafe or unsound or if after the payment of such dividends, the bank would be included in one of the “undercapitalized” categories for capital adequacy purposes pursuant to federal law.

While the Federal Reserve Board has no general restriction with respect to the payment of cash dividends by an adequately capitalized bank to its parent holding company, the Federal Reserve Board might, under certain circumstances, place restrictions on the ability of a particular bank to pay dividends based upon peer group averages and the performance and maturity of the particular bank, or object to management fees to be paid by a subsidiary bank to its holding company on the basis that such fees cannot be supported by the value of the services rendered or are not the result of an arm's length transaction.

Shareholders are entitled to receive dividends only when and if dividends are declared by our Board of Directors. Although we have paid dividends in the past, it is no guarantee that we will pay cash dividends in the future. During 2014, two cash dividends were paid, a $0.10 per common share dividend in January and a $0.065 per common share dividend in July. During 2015, two cash dividends were paid, a $0.10 per common share dividend in January and a $0.11 per common share dividend in July. During 2016, two cash dividends were paid, a $0.12 per common share dividend in January and a $0.12 per common share dividend in July.

Equity Compensation Plan Information

The following table provides information as of December 31, 2016 with respect to shares of our common stock that are issued and currently outstanding under the Company's 1998 Restated Stock Option Plan (the "1998 Restated Stock Option Plan"), and the number of shares that are authorized to be issued under the Company's 2008 Equity Plan (the "2008 Equity Plan").

Plan Category	**A Number of Securities to be Issued Upon Exercise of Outstanding Options**	**B Weighted Average Exercise Price of Outstanding Options**	**C Number of Securities Remaining Available for Future Issuance Under 2008 Equity Plan (Excluding Securities Reflected in Column**

			A)
Equity Compensation Plans Approved by Shareholders	15,000	$ 9.58	1,302,520
Equity Compensation Plans Not Approved by Shareholders	0	0	0
Total	15,000	$ 9.58	1,302,520

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

Not applicable.

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

The following discussion of financial condition as of December 31, 2016 and 2015 and results of operations for each of the years in the two-year period ended December 31, 2016 should be read in conjunction with our consolidated financial statements and related notes thereto, included in this report. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances. This discussion contains forward-looking statements that reflect our plans, estimates and beliefs and involve numerous risks and uncertainties. Actual results may differ materially from those contained in any forward-looking statements. You should carefully read "Special Note Regarding Forward-Looking Statements" included in this report.

Introduction

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

As of December 31, 2016, we had approximately $1 billion in total assets, $611 million in total gross loans, and $914 million in total deposits.

We believe the following were key indicators of our performance during 2016:

Total assets increased to $1 billion at the end of 2016, an increase of 11.6%, from $897 million at the end of 2015.

Total deposits increased to $914 million at the end of 2016, an increase of 12.2%, from $815 million at the end of 2015.

Total net loans increased to $601 million at the end of 2016, an increase of 13.3%, from $530 million at the end of 2015.

Net interest income increased to $31.5 million in 2016, an increase of $6.1 million or 24.1%, compared to 25.4 million in 2015, mainly as a result of growth of our loan and investment portfolios.

Provision for loan losses increased by $609,000 to $484,000 in 2016, compared to the reversal of loan loss provisions totaling $125,000 in 2015, mainly due to loan growth.

The ratio of total non-performing loans to total loans decreased to 0.50% at December 31, 2016 from 1.07% at December 31, 2015. Management considers that the size of the ratio of non-performing assets to total loans is moderate and manageable, and reserves have been taken appropriately.

Total noninterest income increased to $4.4 million in 2016, an increase of 7.5%, from $4.1 million in 2015, which is mainly attributable to our growing deposit account base.

Total noninterest expense increased from $22.7 million in 2015 to $24.3 million in 2016, primarily due to overhead on our new Sonora branch opened in December 2015 and general operating costs to support our growing loan and deposit portfolios.

These items, as well as other factors, such as the acquisition of Mother Lode Bank in December 2015, contributed to the increase in net income for 2016 to $7.67 million from $4.91 million in 2015, which translates into $0.95 per diluted share in 2016 as compared to $0.61 per diluted share in 2015.

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

2017 Outlook

As we begin our strategic business plan for 2017, we remained focused on relationship based expansion throughout our market area. We will continue to focus on increasing our loan-to-deposit ratio to expand our net interest margin, while attempting to control expenses and credit losses.

The decline of market interest rates to historic lows over the past years, has had a negative impact on net interest income despite the increase recognized during 2015 and 2016, which was primarily due to growth of earning assets. We expect the low interest rate environment could have a similar impact in 2017 unless interest rates begin to increase unexpectedly and significantly. The potential compression of net interest income and net interest margin would be a likely outcome if interest rates remain static or decline, given that our balance sheet is asset sensitive to interest rate changes primarily due to the number of variable rate loans and a high level of interest-earning cash balances. This could in turn result in further decrease on the yield of earning assets compared to the cost of deposits and other funds, which have already reached a floor which cannot reasonably be further reduced.

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

For 2017, management remains focused on the above challenges and opportunities and other factors affecting the business similar to the factors driving 2016 results as discussed in this section.

Holding Company

Effective July 3, 2008, Oak Valley Community Bank became a subsidiary of Oak Valley Bancorp, a newly established bank holding company. Oak Valley Bancorp operates Oak Valley Community Bank as a community bank in the general commercial banking business, with our primary market encompassing the California Central Valley around Oakdale and Modesto, and the Eastern Sierras. As such, unless otherwise noted, all references are about Oak Valley Bancorp.

In the bank holding company reorganization, all outstanding shares of common stock of the Bank were exchanged for an equal number of shares of common stock of Oak Valley Bancorp, which now owns the Bank as its wholly-owned subsidiary. Management believes that operating the Bank within a holding company structure, among other things:

provides greater operating flexibility than is currently enjoyed by us.

facilitates the acquisition of related businesses as opportunities arise.

improves our ability to diversify.

enhances our ability to remain competitive in the future with other companies in the financial services industry that are organized in a holding company structure.

enhances our ability to raise capital to support growth.

The financial statements and discussion thereof contained in this report for periods subsequent to the reorganization relate to the consolidated financial statements of Oak Valley Bancorp.

Critical Accounting Policies

Critical accounting policies are those that are both most important to the portrayal of our financial condition and results of operations and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

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

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Management has determined the following accounting policies to be critical:

Asset Impairment Judgments

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

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

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

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

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

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

Allowance for Loan Losses

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

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

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

- the specific review of individual loans,
- the segmenting and review of loan pools with similar characteristics, and
- our judgmental estimate based on various subjective factors:

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

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

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

- concentration of credits,
- nature and volume of the loan portfolio,
- delinquency trends,

- non-accrual loan trend,
- problem loan trend,
- loss and recovery trend,
- quality of loan review,
- lending and management staff,
- lending policies and procedures,
- economic and business conditions, and
- other external factors.

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

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

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

Non-Accrual Loan Policy

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

Income Taxes

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

The Company files income tax returns in the U.S. federal jurisdiction, and the state of California. With few exceptions, the Company is no longer subject to U.S. federal or state/local income tax examinations by tax authorities for years before 2012.

Fair Value Measurements

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

We have established and documented a process for determining fair value. We maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. Whenever there is no readily available market data, management uses its best estimate and assumptions in determining fair value, but these estimates involve inherent uncertainties and the application of management's judgment. As a result, if other assumptions had been used, our recorded earnings or disclosures could have been materially different from those reflected in these financial statements. For detailed information on our use of fair value measurements and our related valuation methodologies, see Note 16 to the Consolidated Financial Statements in Item 8 of this report.

Recently Issued Accounting Standards

In September, 2015, the FASB issued ASU No. 2015-16, *Simplifying the Accounting for Measurement Period Adjustments* (Topic 805). This ASU eliminates the requirement to restate prior period financial statements for measurement period adjustments to assets acquired and liabilities assumed in a business combination. The new guidance under this update requires the cumulative impact of measurement period adjustments be recognized in the period the adjustment is determined. This update does not change what constitutes a measurement period adjustment, nor does it change the length of the measurement period. The new standard is effective for interim annual periods beginning after December 15, 2015 and should be applied prospectively to measurement period adjustments that occur after the effective date. The adoption of this update is not expected to have a material impact on the Company’s consolidated financial statements.

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

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

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

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

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

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

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

ASU 2016-01 is effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. This ASU will impact our financial statement disclosures, however, we do not expect this ASU to have a material impact on our financial condition or results of operations.

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

In March 2016, FASB issued ASU 2016-09, *Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.* The amendments in ASU 2016-09 simplify several aspects of the accounting for share-based payment award transactions, including: (a) income tax consequences; (b) classification of awards as either equity or liabilities; and (c) classification on the statement of cash flows. The amendments are effective for public companies for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any interim or annual period. The Company adopted this ASU for the full fiscal year of 2016 and it did not have a significant impact on its consolidated financial statements.

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

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows – Classification of Certain Cash Receipts and Cash Payments (Topic 230).* This update clarifies how entities should classify certain cash receipts and cash payments on the statement of cash flows with the objective of reducing the existing diversity in practice related to eight specific cash flow issues. The amendments in this update are effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. The Company does not expect the adoption of the amendments within this update will have a material impact on the Company's financial statements.

In January 2017, FASB issued ASU 2017-03, *Accounting Changes and Error Corrections (Topic 250) and Investments - Equity Method and Joint Ventures (Topic 323): Amendments to SEC Paragraphs Pursuant to Staff Announcements at the September 22, 2016 and November 17, 2016 EITF Meetings.* These amendments apply to ASU 2014-9 (Revenue from Contracts with Customers), ASU 2016-02 (Leases), and ASU 2016-13 (Financial Instruments - Credit Losses). The Company does not expect these amendments to have a significant impact on its consolidated financial statements.

Results of Operations

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

Overview

We recorded net income for the year ended December 31, 2016 of $7,665,000 or $0.95 per diluted share compared to $4,908,000 or $0.61 per diluted share for the year ended December 31, 2015. The increase in net income for the year ended December 31, 2016 was primarily due to an increase of $6,120,000 in net interest income, mainly from the growth of our loan and investment portfolios which included the acquisition of Mother Lode Bank in December 2015. Contributing to the net income increase in 2016 was an increase of $306,000 in non-interest income as a result of transaction based service fees from a larger volume of transaction deposit accounts. Partially offsetting these factors was an increase of $1,640,000 in non-interest expense associated with overhead from our new Sonora branch opened in December 2015, an increase in loan loss provisions of $609,000 and an increase in income tax provision of $1,420,000 due to higher levels of pre-tax earnings.

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

(Dollars in thousands, except per share data)	As of and for the years ended December 31, 2016	2015	2014
For the period:			
Net income available to common shareholders	$7,665	$4,908	$7,122
Net income per common share:			
Basic	$0.95	$0.61	$0.90
Diluted	$0.95	$0.61	$0.89
Return on average common equity	9.43 %	6.41 %	10.07 %
Return on average assets	0.83 %	0.63 %	1.03 %
Common stock dividend payout ratio of earnings during the period	25.31 %	34.54 %	18.54 %
Efficiency ratio	63.13 %	68.07 %	67.03 %
At period end:			
Book value per common share	$10.19	$9.69	$9.29
Total assets	$1,002,110	$897,038	$749,665
Total gross loans	$610,949	$541,032	$454,471
Total deposits	$914,093	$814,691	$669,581
Net loan-to-deposit ratio	65.76 %	65.10 %	66.68 %

Net Interest Income and Net Interest Margin

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

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

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

(Dollars in Thousands)	**2016** Average Balance	Interest Income/ Expense	Avg Rate/ Yield	**2015** Average Balance	Interest Income/ Expense	Avg Rate/ Yield
Assets:						
Earning assets:						
Gross loans (1) (2)	$578,339	$27,482	4.75%	$466,509	$22,055	4.73%
Securities of U.S. government agencies	6,460	76	1.18%	8,287	141	1.70%
Other investment securities (2)	140,000	5,071	3.62%	117,756	4,402	3.74%
Federal funds sold	7,003	35	0.50%	13,842	34	0.25%
Interest-earning deposits	122,996	667	0.54%	111,790	304	0.27%
Total interest-earning assets	854,798	33,331	3.90%	718,184	26,936	3.75%
Total noninterest earning assets	72,527			57,356		
Total Assets	$927,325			$775,540		
Liabilities and Shareholders' Equity:						
Interest-bearing liabilities:						
Business Interest DDA	24,114	10	0.04%	20,587	8	0.04%
Money market deposits	287,010	316	0.11%	266,856	283	0.11%
NOW deposits	149,109	151	0.10%	112,472	77	0.07%
Savings deposits	74,669	117	0.16%	48,130	55	0.11%
Time certificates over $250,000	19,560	63	0.32%	14,564	26	0.18%
Other time deposits	33,356	107	0.32%	32,936	166	0.50%
Other borrowings	13	0	1.51%	12	0	0.00%
Total interest-bearing liabilities	587,831	764	0.13%	495,557	615	0.12%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	254,001			199,446		
Other liabilities	4,220			3,999		
Total noninterest-bearing liabilities	258,221			203,445		
Shareholders' equity	81,273			76,538		
Total liabilities and shareholders' equity	$927,325			$775,540		
Net interest income		$32,567			$26,321	
Net interest spread (3)			3.77%			3.63%
Net interest margin (4)			3.81%			3.66%

(1) Loan fees have been included in the calculation of interest income.
(2) Yields on municipal securities and loans have been adjusted to their fully-taxable equivalents (FTE), based on a federal marginal tax rate of 34.0%.
(3) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.
(4) Represents net interest income as a percentage of average interest-earning assets.

Net interest income, on a fully tax equivalent basis (FTE), increased $6,246,000 or 23.7% to $32,567,000 for the year ended December 31, 2016, compared to $26,321,000 in 2015. The Mother Lode Bank acquisition had an impact in the net interest income growth in 2016 compared to 2015, as the Company owned the acquired loans and deposits for all of 2016 but only the final eight days of 2015. Net interest spread and net interest margin were 3.77% and 3.81%, respectively, for the year ended December 31, 2016, compared to 3.63% and 3.66%, respectively, for the year ended December 31, 2015. Overall, the Company has experienced net interest margin compression since the economic downturn in 2008 for several reasons: 1) deposit interest rates have essentially reached a threshold from which they cannot reasonably be further reduced, 2) competition in the lending market has driven new loan rates down, 3) loan and investment portfolio yields continue to decrease due to contractual repricing and 4) deposit growth has out-paced loan growth and the elevated interest-bearing cash balances, which yield approximately 0.75%, have compressed our net interest margin.

The cost of funds on interest-bearing liabilities remained relatively flat at 0.13% in 2016 compared to 0.12% in 2015 as our excess liquidity has allowed us to keep deposit rates at historic lows. Average non-interest-bearing demand deposit balances increased by $54,555,000 in 2016 compared to 2015, which contributed in maintaining our low cost of funds.

Our earning asset yield increased 15 basis points in 2016 compared to 2015. The yield on loans recognized an increase of 2 basis points for 2016 compared to 2015, which was primarily due to the loan discount accretion recognized on the loans acquired from Mother Lode Bank. Excluding the loan discount accretion, we recognized further compression of our loan yield due to competitive pressures on pricing of new loan fundings and the large majority of our loans that are variable and have repricing intervals between one and five years. The drop in loan yield was offset by deploying a portion of the low yielding cash equivalent balances into loan and investment balances which recognized increased average balances of $111,830,000 and $20,417,000, respectively, in 2016 as compared to 2015. Approximately $78 million of the 2016 increase in average loan balances was from organic growth. The remaining increase of approximately $38 million represented loans that were acquired from Mother Lode Bank. Lastly, the recent Federal Reserve interest rate hikes have had a positive impact to our earning asset yield given the large interest-earning cash balances we hold.

Changes in volume resulted in an increase in net interest income (FTE) of $6,013,000 for the year of 2016 compared to the year 2015, and changes in interest rates and the mix resulted in an increase in net interest income (FTE) of $233,000 for the year 2016 versus the year 2015. Management closely monitors both total net interest income and the net interest margin.

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

Federal funds rate by 0.25% to a range of 0.75% to 1.00%.

Rate/Volume Analysis

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

	Rate/Volume Analysis of Net Interest Income					
(Dollars in Thousands)	**For the Year Ended December 31, 2016 vs. 2015 Increases (Decreases) Due to Change In**			**For the Year Ended December 31, 2015 vs. 2014 Increases (Decreases) Due to Change In**		
	Volume	**Rate**	**Total**	**Volume**	**Rate**	**Total**
Interest income:						
Net loans (1)	$5,287	$140	$5,427	$1,845	$(1,808)	$37
Securities of U.S. government agencies	(31)	(34)	(65)	(54)	(17)	(71)
Other Investment securities	832	(163)	669	289	(135)	154
Federal funds sold	(17)	18	1	(6)	2	(4)
Interest-earning deposits	30	333	363	127	(2)	125
Total interest income	6,101	294	6,395	2,201	(1,960)	241
Interest expense:						
Business Interest DDA	$1	$1	$2	$2	$(1)	$1
Money market deposits	21	12	33	33	(27)	6
NOW deposits	25	49	74	11	(3)	8
Savings deposits	30	32	62	9	3	12
Time certificates over $250,000	9	28	37	14	(20)	(6)
Other time deposits	2	(61)	(59)	(42)	(11)	(53)
Other borrowings	0	0	0	0	0	0
Total interest expense	88	61	149	27	(59)	(32)
Change in net interest income	$6,013	$233	$6,246	$2,174	$(1,901)	$273

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

Provision for Loan Losses

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

The Company recorded a provision for loan losses of $484,000 during the year ended December 31, 2016 mainly to provide an adequate loan loss reserve for the new loan fundings, as compared to a reversal of loan loss provisions of $125,000 for the year ended December 31, 2015 due to a sale of the collateral property and subsequent pay off of an impaired loan. Nonperforming loans were $3,037,000 at December 31, 2016 and $5,816,000 at December 31, 2015, or 0.50% and 1.07%, respectively, of total loans. Nonperforming loans are primarily in nonperforming real estate construction and development loans. The allowance for loan losses was $7,832,000 and $7,356,000 at December 31, 2016 and 2015, or 1.28% and 1.36%, respectively, of total loans. The decrease in the allowance for loan losses as a percentage of total loans is due to the decrease in non-accrual loans and noted trends in improved credit quality. The improved credit quality lead to a decrease in net charge-offs totaling $8,000 in 2016, compared to $53,000 in 2015.

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

Noninterest Income

Noninterest income was $4,413,000 for the year ended December 31, 2016, compared to $4,107,000 for the year 2015. In 2016, other income increased by $278,000, which was attributable to increases in debit card interchange fee income, FHLB stock dividends and merchant services fee income of $168,000, $53,000 and $46,000, respectively, compared to 2015. Mortgage commissions have increased by $56,000 or 37.8% for the year 2016, as compared to 2015, as a result of the increased demand for home purchases and refinancing. Service charge income increased to $1,354,000 for the year 2016 compared to $1,240,000 for the year 2015, as a result of the increase in the aggregate number of transaction deposit accounts and corresponding service fee income. Earnings on cash surrender value of life insurance and gains recognized a modest gain of $12,000 in 2016 compared to 2015, due to the additional life insurance policies totaling $4 million purchased on certain directors and officers during the fourth quarter of 2016. Gains on called securities decreased from $206,000 in 2015 to $52,000 in 2016, as the volume of call activity slowed considerably in 2016 compared to 2015. The Mother Lode Bank acquisition had an impact in the non-interest income growth in 2016 compared to 2015, particularly on service charges on deposit accounts, as the Company owned the acquired loans and deposits for all of 2016 but only the final eight days of 2015. The Company continues to evaluate its deposit product offerings with the intention of continuing to expand its offerings to the consumer and business depositors.

Noninterest Income

(Dollars in thousands)

For the Years Ended December 31,

	2016 (Amount)	**(%)**	**2015 (Amount)**	**(%)**
Service charges on deposit accounts	$1,354	30.7%	$1,240	30.2%
Earnings on cash surrender value of life insurance	441	10.0%	429	10.5%
Mortgage commissions	204	4.6%	148	3.6%
Gains on called/sold securities	52	1.2%	206	5.0%
Other income	2,362	53.5%	2,084	50.7%
Total	$4,413	100.0%	$4,107	100.0%
Average assets	$927,325		$775,540	
Noninterest income as a % of average assets		0.5%		0.5%

Noninterest Expense

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

Noninterest Expense

(Dollars in thousands)

	For the Years Ended December 31,			
	2016		**2015**	
	(Amount)	**(%)**	**(Amount)**	**(%)**
Salaries and employee benefits	$13,564	55.8%	$11,717	51.7%
Occupancy expenses	3,284	13.5%	3,009	13.3%
Data processing fees	1,604	6.6%	1,466	6.5%
Regulatory assessments (FDIC & DBO)	643	2.6%	506	2.2%
Other operating expenses	5,220	21.5%	5,977	26.3%
Total	$24,315	100.0%	$22,675	100.0%
Average assets	$927,325		$775,540	
Noninterest expenses as a % of average assets		2.6%		2.9%

Noninterest expense was $24,315,000 for the year ended December 31, 2016, an increase of $1,640,000 or 7.2% compared to $22,675,000 for the year ended 2015. Salaries and employee benefits increased by $1,847,000 in 2016 to $13,564,000 compared to the prior year. To support loan and deposit growth and continue our emphasis on superior customer service, we increased our full-time equivalent staff by 6 as of December 31, 2016 compared to last year, which resulted in increased salary expense and group medical insurance benefits. Much of this increase was due to the impact of the Sonora branch opened in December 2015 and the nine employees that were hired from Mother Lode Bank in December 2015.

Occupancy expense realized an increase of $275,000 in 2016 compared to the prior year, primarily from rent and other overhead expenses from the new Sonora branch opened in December 2015 and a new credit administration facility that we moved into during March of 2016. The Mother Lode Bank acquisition had minimal impact on occupancy expense in 2016, as both acquired branches were closed during January 2016.

Data processing costs increased in 2016 over 2015 by $138,000, primarily due to servicing costs on the acquired deposits and loans from Mother Lode Bank, but we have gained cost efficiencies since the data systems conversion completed during the second quarter of 2016.

FDIC and DBO (California Department of Business Oversight) regulatory assessments increased by $137,000 to $643,000 in 2016 compared to $506,000 in 2015. The initial base assessment rate for financial institutions varies based on the overall risk profile of the institution as defined by the FDIC and our risk profile has remained stable during 2015 and 2016. The increase to our recorded expense in 2016 is the result of the higher deposit balances in 2016, due in part to the $71 million acquired from Mother Lode Bank, as the FDIC assessment rates are applied to average quarterly total liabilities as the primary basis. In April of 2016 the FDIC changed the methodology for determining the assessment rate, which appeared on the December 31, 2016 invoice. The result was a reduction in our assessment rate, however we expect to be offset by deposit growth in 2017.

Other operating expenses decreased in 2016 by $757,000 compared to 2015, primarily due to the $1,971,000 in one-time merger related expenses associated with the Mother Lode Bank acquisition recorded during 2015 as compared to $173,000 in 2016. Offsetting the reduction in merger related expenses, were OREO expenses and impaired loan expenses totaling $385,000 and $46,000 recorded during 2016, respectively, as compared to $11,000 and a net expense recovery of $139,000 recognized in 2015.

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

Provision for Income Taxes

We reported a provision for income taxes of $3,474,000 and $2,054,000 for the years 2016 and 2015, respectively. The effective income tax rate on income from continuing operations was 31.2% for the year ended December 31, 2016 compared to 29.5% for the year 2015. These provisions reflect accruals for taxes at the applicable rates for federal income tax and California franchise tax based upon reported pre-tax income, and adjusted for the effects of all permanent differences between income for tax and financial reporting purposes (such as earnings on qualified municipal securities, BOLI and certain tax-exempt loans). The disparity between the effective tax rates in 2016 as compared to 2015 is primarily due to tax credits from California Enterprise Zones and low income housing projects as well as tax free-income on loans within these enterprise zones and municipal securities and loans that comprise a larger proportion of pre-tax income in 2015 as compared to 2016. We have not been subject to an alternative minimum tax ("AMT") during these periods.

Financial Condition

The Company’s total assets were $1,002,110,000 at December 31, 2016 compared to $897,038,000 at December 31, 2015, an increase of $105,072,000 or 11.7%. Net loans increased $70,710,000, investments increased $28,787,000, bank premises and equipment decreased $589,000, interest receivable and other assets increased $6,126,000, while cash and cash equivalents increased $207,000 for the year ended December 31, 2016 as compared to December 31, 2015.

Loans gross of the allowance for loan losses and deferred fees were $610,949,000 at December 31, 2016, compared to $541,032,000 at December 31, 2015, an increase of $69,917,000 or 12.9%. The increase was primarily due to an increase of $55,808,000 or 13.2% in commercial real estate loans, an increase of $425,000 or 0.7% in commercial and industrial loans, an increase of $6,077,000 or 18.2% in consumer loans and consumer residential loans and an increase of $7,607,000 or 36.5% in agriculture loans. The composition of the loan portfolio categories remained relatively unchanged as a percentage of total loans, with commercial real estate comprising 78% of the loan portfolio at December 31, 2016 and 2015.

Deposits increased $99,402,000 or 12.2% to $914,093,000 at December 31, 2016 compared to $814,691,000 at December 31, 2015. Time deposits increased by $3,824,000, while Demand, NOW, Money Market and Savings increased by $56,716,000, $34,173,000, $1,194,000 and $3,495,000, respectively, as of December 31, 2016 as compared to December 31, 2015.

There were no short-term borrowing or long-term debt outstanding balances at December 31, 2016 and 2015. The Company uses short-term borrowings, primarily short-term FHLB advances, to fund short-term liquidity needs and manage net interest margin.

Equity increased $4,187,000 or 5.3% to $82,450,000 at December 31, 2016, compared to $78,263,000 at December 31, 2015. The Company did not issue any stock to Mother Lode Bank shareholders as it was paid 100% in cash, and therefore there was no impact to equity other than the merger related expenses and exclusions of goodwill and intangibles, which are excluded from tangible equity.

Investment Activities

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

Cash Equivalents and Interest-bearing Deposits in other Financial Institutions

The Company holds federal funds sold, unpledged available-for-sale securities and salable government guaranteed loans to help meet liquidity requirements and provide temporary holdings until the funds can be otherwise deployed or invested. As of December 31, 2016, and 2015, we had $11,785,000 and $15,825,000, respectively, in federal funds sold.

Investment Securities

Management of our investment securities portfolio focuses on providing an adequate level of liquidity and establishing an interest rate-sensitive position, while earning an adequate level of investment income without taking undue risk. Investment securities that we intend to hold until maturity are classified as held-to-maturity securities, and all other investment securities are classified as available-for-sale. Currently, all of our investment securities are classified as available-for-sale. The carrying values of available-for-sale investment securities are adjusted for unrealized gains or losses as a valuation allowance and any gain or loss is reported on an after-tax basis as a component of other comprehensive income.

Our investment securities holdings increased by $28,787,000, or 21.9%, to $160,333,000 at December 31, 2016, compared to holdings of $131,546,000 at December 31, 2015. Total investment securities as a percentage of total assets increased to 16.0% as of December 31, 2016 compared to 14.7% at December 31, 2015. As of December 31, 2016, $89,362,000 of the investment securities were pledged to secure public deposits.

As of December 31, 2016, the total unrealized loss on securities that were in a loss position for less than 12 continuous months was $2,000,000 with an aggregate fair value of $78,839,000. The total unrealized loss on securities that were in a loss position for greater than 12 continuous months was $436,000 with an aggregate fair value of $16,088,000.

The following table summarizes the book value and fair value and distribution of our investment securities as of the dates indicated:

Investment Securities Portfolio

Dollars in Thousands	December 31, 2016 Amortized Cost	Market Value	December 31, 2015 Amortized Cost	Market Value	December 31, 2014 Amortized Cost	Market Value
Available-for-Sale:						
U.S. agencies	$27,879	$28,286	$31,815	$32,868	$40,316	$41,930
Collateralized mortgage obligations	4,159	4,109	2,729	2,719	6,927	7,072
Municipal securities	77,957	78,329	66,535	68,586	49,396	50,897
SBA Pools	7,219	7,168	811	806	895	892
Corporate debt	21,349	20,563	13,497	13,420	6,726	6,804

Asset backed Securities	18,888	18,819	10,321	10,138	10,766	10,710
Mutual fund	3,264	3,059	3,172	3,009	3,077	2,972
Total investment securities	$160,715	$160,333	$128,880	$131,546	$118,103	$121,277

At December 31, 2016, there was one U.S. agency, one municipality, two SBA pools, four corporate debts, five asset backed securities, and one mutual fund that comprised the total securities in an unrealized loss position for greater than 12 months and seven U.S. agencies, two collateralized mortgage obligations, forty-four municipalities, three SBA pools, eight corporate debts, and one asset backed security that make up the total securities in a loss position for less than 12 months. Management periodically evaluates each available-for-sale investment security in an unrealized loss position to determine if the impairment is temporary or other than temporary. This evaluation encompasses various factors including, the nature of the investment, the cause of the impairment, the severity and duration of the impairment, credit ratings and other credit related factors such as third party guarantees and volatility of the security's fair value. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due primarily to interest rate changes and the Company does not intend to sell the securities and it is not likely that we will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security. As of December 31, 2016, we did not have any investment securities that constituted 10% or more of the stockholders' equity of any third party issuer.

The following table summarizes the maturity and repricing schedule of our investment securities at their amortized cost and their weighted average yields at December 31, 2016:

Investment Maturities and Repricing Schedule

(Dollars in Thousands)	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years		Total	
	Amount	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**
Available-for-sale:										
U.S. agencies	$2,214	1.00%	$5,448	4.58%	$4,674	2.26%	$15,543	2.86%	$27,879	2.95%
Collateralized mortgage obligations	0	0.00%	0	0.00%	0	0.00%	4,159	2.17%	4,159	2.17%
Municipalities	3,673	4.52%	38,077	2.20%	32,356	3.07%	3,851	4.06%	77,957	2.76%
SBA Pools	0	0.00%	0	0.00%	4,129	2.08%	3,090	2.05%	7,219	2.07%
Corporate debt	3,994	3.10%	8,855	2.27%	6,000	2.69%	2,500	3.99%	21,349	2.74%
Asset Backed Securities	0	0.00%	0	0.00%	17,944	2.86%	944	2.54%	18,888	2.84%
Mutual Fund	0	0.00%	0	0.00%	0	0.00%	3,264	3.12%	3,264	3.12%
Total Investment Securities	$9,881	3.16%	$52,380	2.46%	$65,103	2.86%	$33,351	2.94%	$160,715	2.76%

Yields in the above table have not been adjusted to a fully tax equivalent basis. Securities are reported at the earliest possible call, repricing or maturity date.

Loans

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

(Dollars in Thousands)	**YEARS ENDED DECEMBER 31,**

	2016	**2015**	**2014**	**2013**	**2012**
Commercial real estate	$478,855	$423,047	$358,398	$332,874	$316,075
Commercial and industrial	64,201	63,776	54,051	48,787	36,529
Consumer	767	774	805	883	1,096
Consumer residential	38,672	32,588	25,464	25,623	25,659
Agriculture	28,454	20,847	15,753	11,272	11,628
Unearned income	(2,013)	(3,282)	(446)	(624)	(600)
Total Loans, net of unearned income	$608,936	$537,750	$454,025	$418,815	$390,387
Participation loans sold and serviced by the Bank	21,348	19,848	16,243	11,733	8,045
Commercial real estate	78.6 %	78.7 %	78.9 %	79.5 %	80.9 %
Commercial and industrial	10.5 %	11.9 %	11.9 %	11.6 %	9.4 %
Consumer	0.1 %	0.1 %	0.2 %	0.2 %	0.3 %
Consumer residential	6.4 %	6.1 %	5.6 %	6.1 %	6.6 %
Agriculture	4.7 %	3.9 %	3.5 %	2.7 %	3.0 %
Unearned income	-0.3 %	-0.6 %	-0.1 %	-0.1 %	-0.2 %
Total Loans, net of unearned income	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %

Commercial real estate loans increased $55,808,000 in 2016 as compared to 2015, as a result of the increased demand by qualified borrowers in our serving area. Of the commercial real estate loans at December 31, 2016, 59.1% are non-owner occupied and 40.9% are owner occupied. Our commercial real estate loan portfolio is weighted towards term loans for which the primary source of repayment is cash flow from net operating income of the real estate property.

Commercial and industrial loans increased $425,000 in 2016 as compared to 2015. We have historically targeted well-established local businesses with strong guarantors that have proven to be resilient in periods of economic stress.

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

The following table summarizes our commercial real estate loan portfolio by the geographic location in which the property is located as of December 31, 2016 and 2015:

Commercial Real Estate Loans Outstanding by Geographic Location

(Dollars in Thousands)	December 31, 2016		December 31, 2015	
Commercial real estate loans by geographic location (County)	**Amount**	**% of Commercial Real Estate Loans**	**Amount**	**% of Commercial Real Estate Loans**
Stanislaus	$170,200	35.5%	$141,694	33.5%
San Joaquin	91,491	19.1%	91,323	21.6%
Tuolumne	33,912	7.1%	36,733	8.7%
Fresno	28,710	6.0%	19,836	4.7%
Merced	19,263	4.0%	13,903	3.3%
Sacramento	18,621	3.9%	9,397	2.2%
San Luis Obispo	11,715	2.4%	8,911	2.1%
Madera	10,005	2.1%	10,233	2.4%
Calaveras	8,601	1.8%	7,474	1.8%
Inyo	7,467	1.6%	6,511	1.5%
Alameda	6,892	1.4%	13,030	3.1%
Mono	6,769	1.4%	8,060	1.9%
Sonoma	6,153	1.3%	6,898	1.6%
San Francisco	5,633	1.2%	0	0.0%

Contra Costa	5,589	1.2%	5,756	1.4%
Solano	5,069	1.1%	4,168	1.0%
Butte	4,243	0.9%	4,319	1.0%
Marin	3,571	0.7%	5,681	1.3%
Santa Clara	3,010	0.6%	4,328	1.0%
Other	31,941	6.7%	24,792	5.9%
Total	**$478,855**	**100.0%**	**$423,047**	**100.0%**

Construction and land loans are classified as commercial real estate loans and increased $3.6 million in 2016 as compared to 2015. The table below shows an analysis of construction loans by type and location. Non-owner-occupied land loans of $9.8 million at December 31, 2016 included loans for lands specified for commercial development of $4.9 million and for residential development of $4.9 million, the majority of which are located in Stanislaus County.

Construction and Land Loans Outstanding by Type and Geographic Location

(Dollars in Thousands)	**December 31, 2016**		**December 31, 2015**	
Construction and land loans by type	**Amount**	**% of Construction and Land Loans**	**Amount**	**% of Construction and Land Loans**
Single family non-owner-occupied	$6,210	18.7%	$1,985	6.7%
Single family owner-occupied	376	1.1%	1,056	3.6%
Commercial non-owner-occupied	10,360	31.2%	11,043	37.3%
Commercial owner-occupied	6,432	19.4%	5,279	17.8%
Land non-owner-occupied	9,823	29.6%	10,239	34.6%
Total	**$33,201**	**100.0%**	**$29,602**	**100.0%**

Construction and land loans by geographic location (County)	**Amount**	**% of Construction and Land Loans**	**Amount**	**% of Construction and Land Loans**
Stanislaus	$10,804	32.5%	$10,731	36.3%
San Joaquin	4,900	14.8%	2,593	8.8%
Placer	3,980	12.0%	0	0.0%
Mono	2,495	7.5%	2,350	7.9%
San Mateo	1,864	5.6%	0	0.0%
Merced	1,630	4.9%	0	0.0%
Los Angeles	1,470	4.4%	2,150	7.3%
Tuolumne	1,406	4.2%	2,031	6.9%
Solano	1,080	3.3%	0	0.0%
Calaveras	1,047	3.1%	655	2.2%
Nevada	818	2.5%	1,051	3.5%
Kings	580	1.8%	0	0.0%
Contra Costa	370	1.1%	370	1.3%
Fresno	218	0.7%	4,974	16.8%
Inyo	92	0.3%	113	0.4%

San Bernardino	0	0.0%	1,822	6.1%
Amador	0	0.0%	309	1.0%
Other	447	1.4%	453	1.5%
Total	**$33,201**	**100.0%**	**$29,602**	**100.0%**

Loan Maturities

The following table shows the contractual maturity distribution and repricing intervals of the outstanding loans in our portfolio, as of December 31, 2016. In addition, the table shows the distribution of such loans between those with variable or floating interest rates and those with fixed or predetermined interest rates. The large majority of the variable rate loans are tied to independent indices (such as the Wall Street Journal prime rate or a Treasury Constant Maturity Rate). Substantially all loans with an original term of more than five years have provisions for the fixed rates to reset, or convert to a variable rate, after one, three or five years.

Loan Maturities and Repricing Schedule
At December 31, 2016

	Within One Year	After One But Within Five Years	After Five Years	Total
Commercial real estate	$66,796	$277,077	$134,982	$478,855
Commercial & industrial	33,775	19,963	10,463	64,201
Consumer	467	260	40	767
Consumer residential	3,942	9,777	24,953	38,672
Agriculture	25,379	2,347	728	28,454
Unearned income	(435)	(1,034)	(544)	(2,013)
Total loans, net of unearned income	$129,925	$308,390	$170,622	$608,936
Loans with variable (floating) interest rates	$122,693	$242,412	$77,946	$443,052
Loans with predetermined (fixed) interest rates	$7,231	$65,977	$92,676	$165,884

The majority of the properties taken as collateral are located in Northern California. We employ strict guidelines regarding the use of collateral located in less familiar market areas. The recent decline in Northern California real estate value is offset by the low loan-to-value ratios in our commercial real estate portfolio and high percentage of owner-occupied properties.

Nonperforming Assets

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

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

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

The Company had nonperforming loans of $3.04 million at December 31, 2016, as compared to $5.82 million at December 31, 2015, $4.70 million at December 31, 2014, $2.34 million at December 31, 2013 and $6.92 million at December 31, 2012. The ratio of nonperforming loans over total loans was 0.50%, 1.07%, 1.03%, 0.56% and 1.77% at December 31, 2016, 2015, 2014 and 2012, respectively.

In addition, the Company held three OREO properties with outstanding balances of approximately $1,210,000 as of December 31, 2016, one of which consisted of residential land acquired through foreclosure that was written down to a zero balance because the public utilities have not been obtainable rendering these land lots unmarketable at this time. The Company held five OREO properties with outstanding balances of approximately $2,066,000 as of December 31, 2015 and held three properties with balances of approximately $884,000 and $916,000 as of December 31, 2014 and 2013, respectively. The Company held only the one zero-balance property as of December 31, 2012.

Management believes that the reserve provided for nonperforming loans, together with the tangible collateral, were adequate as of December 31, 2016. See “Allowance for Loan Losses” below for further discussion. Except as disclosed above, as of December 31, 2016, management was not aware of any material credit problems of borrowers that would cause it to have serious doubts about the ability of a borrower to comply with the present loan payment terms. However, no assurance can be given that credit problems may exist that may not have been brought to the attention of management, or that credit problems may not arise in the future.

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

(Dollars in Thousands)	**At December 31,**				
	2016	**2015**	**2014**	**2013**	**2012**
Nonaccrual loans(1)					
Commercial real estate	$2,715	$2,790	$4,363	$2,322	$5,891
Commercial and industrial	306	322	337	18	21
Consumer	0	0	0	0	0
Consumer residential	16	0	0	0	1011
Agriculture	0	2704	0	0	0
Total	$3,037	$5,816	$4,700	$2,340	$6,923
Loans 90 days or more past due and still accruing (as to principal or interest):					
Commercial real estate	$0	$0	$0	$0	$0
Commercial and industrial	0	0	0	0	0
Consumer	0	0	0	0	0
Consumer residential	0	0	0	0	0
Agriculture	0	0	0	0	0
Total	0	0	0	0	0
Total nonperforming loans	3,037	5,816	4,700	2,340	6,923
Other real estate owned	1,210	2,066	884	916	0
Total nonperforming assets	$4,247	$7,882	$5,584	$3,256	$6,923
Accruing restructured loans (2)					
Commercial real estate	$0	$0	$0	$0	$0
Commercial and industrial	0	0	0	0	0
Consumer	0	0	0	0	0
Consumer residential	0	0	0	0	0
Agriculture	0	0	0	0	0
Total	0	0	0	0	0
Total impaired loans	$3,037	$5,816	$4,700	$2,340	$6,923
Nonperforming loans as a percentage of total loans	0.50 %	1.07 %	1.03 %	0.56 %	1.77 %
Nonperforming assets as a percentage of total loans and other real estate owned	0.69 %	1.45 %	1.23 %	0.77 %	1.77 %
Allowance for loan losses as a percentage of nonperforming loans	257.89%	126.48%	160.30%	327.37%	115.19%

(1) During the fiscal year ended December 31, 2016 and 2015, no interest income related to these loans was included in net income while on nonaccrual status. Additional interest income of approximately $156,000 and $376,000 would

have been recorded during the year ended December 31, 2016 and 2015, respectively, if these loans had been paid in accordance with their original terms.

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

Allowance for Loan Losses

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

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

Historically, over the past five years, the economic recovery has had a positive impact on the financial stability of our borrowers resulting in improvements in credit quality of our loan portfolio which has allowed us to reduce the reserve for loan losses. In 2016, we have continued to benefit from the improved credit quality but due to strong loan growth, we recognized an increase of $476,000 in the allowance for loan losses to $7,832,000 at December 31, 2016, as compared with $7,356,000 at December 31, 2015. Such allowances were $7,534,000, $7,659,000 and $7,975,000 at December 31, 2014, 2013 and 2012, respectively. In 2016, the allowance for loan losses as a percentage of total loans decreased corresponding to our improved credit quality and loan growth, as reflected in the ratios of 1.28%, 1.36%, 1.66%, 1.83% and 2.04%, at the end of 2016, 2015, 2014, 2013 and 2012, respectively. The decrease at the end of 2015 and 2016 is due in part to the acquisition of $42,831,000 in loans from Mother Lode Bank which are recorded at fair value and therefore do not require a loan loss reserve. Based on the current conditions of the loan portfolio, management believes that the $7,832,000 allowance for loan losses at December 31, 2016 is adequate to absorb losses inherent in our loan portfolio. No assurance can be given, however, that adverse economic conditions or other circumstances will not result in increased losses in the portfolio.

Diversification, low loan-to-values, strong credit quality and enhanced credit monitoring contribute to a reduction in the portfolio’s overall risk, and help to offset the economic risk. The impact of the economic environment will continue to be monitored, and adjustments to the provision for loan loss will be made accordingly. During 2016, the Company recognized net loan charge-offs of $8,000 as compared to $53,000 in 2015. In 2014, we recorded net loan recoveries of $1,752,000, primarily from one loan for which we received a net settlement of $2,923,000, resulting in a recovery of $1,877,000. In prior years, the weak business climate adversely impacted the financial conditions of some of our clients and resulted in net loan charge-offs of $616,000 and $1,784,000 in 2013 and 2012, respectively.

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

Although management believes the allowance at December 31, 2016 was adequate to absorb losses from any known and inherent risks in the portfolio, no assurance can be given that economic conditions which adversely affect our service areas or other variables will not result in increased losses in the loan portfolio in the future.

As of December 31, 2016, our allowance for loan losses consisted of amounts allocated to three phases of our methodology for assessing loan loss allowances, as follows (see details of methodology for assessing allowance for loan losses in the section entitled "Critical Accounting Policies"):

(Dollars in Thousands)	**Years Ended December 31,**		
Phase of Methodology	**2016**	**2015**	**2014**
Specific review of individual loans	$680	$722	$993
Review of portfolio based on loss trends and current economic climate	4,543	4,423	4,388
Review of portfolio based on inherent risk and other subjective factors	2,609	2,211	2,153
	$7,832	$7,356	$7,534

The Components of the Allowance for Loan Losses

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

The first component, the specific allowance, results from the analysis of identified problem credits and the evaluation of sources of repayment including collateral, as applicable. Through Management's ongoing loan grading process, individual loans are identified that have conditions that indicate the borrower may be unable to pay all amounts due under the contractual terms. These loans are evaluated individually by Management and specified allowances for loan losses are established when the discounted cash flows of future payments or collateral value of collateral-dependent loans are lower than the recorded investment in the loan. Generally with problem credits that are collateral-dependent, we obtain appraisals of the collateral at least annually. We may obtain appraisals more frequently if we believe the collateral value is subject to market volatility, if a specific event has occurred to the collateral (e.g. tentative map has been filed), or if we believe foreclosure is imminent. Impaired loan balances decreased from $5,816,000 at December 31, 2015 to $3,037,000 at December 31, 2016. The specific allowance totaled $680,000 and $722,000 at December 31, 2016 and 2015, respectively, as we charge off substantially all of our estimated losses related to specifically identified impaired loans as the losses are identified.

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

The total amount allocated for the second component is determined by applying loss estimation factors based on loss history to outstanding loans. At December 31, 2016 and 2015, the allowance allocated by categories of credits totaled $4.5 million and $4.4 million, respectively.

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

"Critical Accounting Policies". At December 31, 2016 and 2015, the general valuation allowance, including the economic component, totaled $2.6 million and $2.2 million, respectively. Starting in late 2008, we witnessed financial difficulties experienced by borrowers in our market, where real estate sale prices declined and holding periods increased. In the past several years, while published economic data indicates that the downturn is behind us, it is not clear at what speed the economy will recover. In response to this, we have been proactive in evaluating reserve percentages for economic and other qualitative loss factors used to determine the adequacy of the allowance for loan losses. The increase to the third component of the allowance for loan losses reflected such evaluation.

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

Allowance for Loan Losses

(Dollars in thousands)	**2016**	**2015**	**2014**	**2013**	**2012**
Balances:					
Average total loans outstanding during period	$578,339	$466,509	$430,448	$396,953	$390,856
Total loans outstanding at end of period	$610,949	$541,032	$454,471	$419,438	$390,986
Allowance for loan losses:					
Balances at beginning of period	$7,356	$7,534	$7,659	$7,975	$8,609
Actual charge-offs:					
Commercial real estate	0	0	103	436	1,663
Commercial and Industrial	0	32	0	0	0
Consumer	18	30	40	22	26
Consumer Residential	0	0	0	178	150
Agriculture	0	0	0	0	0
Total charge-offs	18	62	143	636	1,839
Recoveries on loans previously charged off:					
Commercial real estate	4	5	1,882	8	35
Commercial and Industrial	0	0	0	0	1
Consumer	5	4	2	3	4
Consumer Residential	1	0	11	9	15
Agriculture	0	0	0	0	0
Total recoveries	10	9	1,895	20	55
Net loan charge-offs (recoveries)	8	53	(1,752)	616	1,784
Provision (reversal) for loan losses	484	(125)	(1,877)	300	1,150
Balance at end of period	$7,832	$7,356	$7,534	$7,659	$7,975
Ratios:					
Net loan charge-offs (recoveries) to average total loans	0.00%	0.01%	-0.41%	0.16%	0.46%
Allowance for loan losses to total loans at end of period	1.28%	1.36%	1.66%	1.83%	2.04%
Net loan charge-offs (recoveries) to allowance for loan losses at end of period	0.10%	0.72%	-23.25%	8.04%	22.37%

Net loan charge-offs to provision for loan losses	1.65 %	N/A	N/A	205.33 %	155.13 %

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

Allocation of the Allowance for Loan Losses

(Dollars in thousands)	Amount Outstanding as of December 31,				
	2016	**2015**	**2014**	**2013**	**2012**
Applicable to:					
Commercial real estate	$6,185	$5,920	$5,963	$6,248	$6,571
Commercial and Industrial	697	627	720	663	474
Consumer	51	38	42	47	50
Consumer Residential	325	426	388	440	384
Agriculture	504	309	286	217	286
Unallocated	70	36	135	44	210
Total Allowance	$7,832	$7,356	$7,534	$7,659	$7,975

Other Earning Assets

For various business purposes, we make investments in earning assets other than the interest-earning securities and loans discussed above. The primary other earning assets held by the Company as of December 31, 2016 and 2015, includes the cash surrender value of the Bank Owned Life Insurance ("BOLI") policies, Federal Home Loan Bank stock and Federal Reserve Bank stock. As of December 31, 2015 and 2016, we also held an investment in a low-income housing tax credit funds ("LIHTCF") to promote our participation in CRA activities. The original investment was $1 million, and there were no unfunded commitments as of December 31, 2015 and 2016. We receive the return in the form of tax credits and tax deductions are expected to continue through the year 2022. The $1 million contribution is being amortized to other expenses over a term of 15 years, commensurate with the benefits received.

The balances of other earning assets as of December 31, 2016 and December 31, 2015 were as follows:

(Dollars in Thousands)	**December 31, 2016**	**December 31, 2015**
BOLI	$ 18,004	$ 13,747
LIHTCF	$ 328	$ 388

Federal Reserve Bank Stock	$ 758	$ 758
Federal Home Loan Bank Stock	$ 3,037	$ 2,958

Deposits and Other Sources of Funds

Deposits

Total deposits at December 31, 2016 and 2015 were $914,093,000 and $814,691,000, respectively, representing an increase of $99,402,000 or 12.2% in 2016. The average deposits for the year ended December 31, 2016 increased $146,828,000 or 21.1% to $841,819,000 compared to $694,991,000 at December 31, 2015. The increase in the average deposits was impacted by the $71,125,000 acquired in deposits from Mother Lode Bank.

Deposits are the Company’s primary source of funds. Due to strategic emphasis by management, core deposits (based on definition provided by FDIC’s Uniform Bank Performance Report) increased by $94.2 million or 11.8% in 2016 to $892.8 million at December 31, 2016. The percentage of core deposits to total deposits decreased slightly to 97.7% at December 31, 2016 as compared to 98.0% at December 31, 2015. The average rate paid on time deposits in denominations of over $250,000 was 0.32% and 0.18% for the years ended December 31, 2016 and 2015, respectively. The composition and cost of the Company's deposit base are important components in analyzing the Company's net interest margin and balance sheet liquidity characteristics, both of which are discussed in greater detail in other sections herein. See “Net Interest Income and Net Interest Margin” for further discussion.

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

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

Distribution of Average Daily Deposits

	Average Deposits					
	2016		**2015**		**2014**	
(Dollars in Thousands)	**Average Balance**	**Average Rate**	**Average Balance**	**Average Rate**	**Average Balance**	**Average Rate**
Demand	$278,115	0.00%	$220,033	0.00%	$191,667	0.00%
Money market	287,010	0.11%	266,856	0.11%	238,736	0.12%
NOW	149,109	0.10%	112,472	0.07%	97,080	0.07%
Savings	74,669	0.16%	48,130	0.11%	39,820	0.11%
Time certificates of deposit over $250,000	19,560	0.32%	14,564	0.18%	10,141	0.32%
Other time deposits	33,356	0.32%	32,936	0.50%	40,831	0.54%
Total deposits	$841,819	0.17%	$694,991	0.17%	$618,275	0.20%

The scheduled maturities of our time deposits in denominations of more than $250,000 at December 31, 2016 are, as follows:

Maturities of Time Deposits over $250,000

(Dollars in Thousands)

Three months or less	$	5,948
Over three months through six months		1,690
Over six months through twelve months		6,732
Over twelve months		6,600
Total	$	20,970

Because our client base is comprised primarily of commercial and industrial accounts, individual account balances are generally higher than those of consumer-oriented banks. Seven of our clients carry deposit balances of more than 1% of our total deposits, one of which had a deposit balance of more than 3% of total deposits at December 31, 2016.

The Company had $50,000 and $1,001,000 in brokered deposits as of December 31, 2016 and 2015, respectively. The only brokered deposits the Company holds are from CDARS and ICS, a certificate of deposit and money market account program, respectively, that exchanges funds with other network banks to offer full FDIC insurance coverage to the customer.

FHLB Borrowings

Although deposits are the primary source of funds for our lending and investment activities and for general business purposes, we may obtain advances from the Federal Home Loan Bank of San Francisco ("FHLB") as an alternative to retail deposit funds. We had no outstanding balances as of December 31, 2016 and 2015 and the average outstanding balance was $13, 000 and $12,000 in 2016 and 2015, respectively. See "Liquidity Management" below for the details on the FHLB borrowings program.

Return on Equity and Assets

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

	Year Ended December 31,	
	2016	**2015**
Return on average assets	0.83 %	0.63 %
Return on average common equity	9.43 %	6.41 %
Dividend payout ratio	25.31%	34.54%
Equity to assets ratio	8.23 %	8.72 %

Deferred Compensation Obligations

We maintain a nonqualified, unfunded deferred compensation plan for certain key management personnel. Under this plan, participating employees may defer compensation, which will entitle them to receive certain payments upon retirement, death, or disability. The plan provides for payments commencing upon retirement and reduced benefits upon early retirement, disability, or termination of employment. At December 31, 2016 and 2015, our aggregate payment obligations under this plan totaled $9.0 million and $7.7 million, respectively.

Off-Balance Sheet Arrangements

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

As of December 31, 2016, and 2015, we had commitments to extend credit of $110.8 million and $91.7 million, respectively. Obligations under standby letters of credit, included in total commitments to extend credit, were $1.3 million and $1.6 million at December 31, 2016 and 2015, respectively, and there were no obligations under commercial letters of credit for either period.

The effect on our revenues, expenses, cash flows and liquidity from the unused portion of the commitments to provide credit cannot be reasonably predicted because there is no guarantee that the lines of credit will be used. For more information regarding our off balance sheet arrangements, see Note 14- Commitments and Other Contingencies- to our 2016 year-end consolidated financial statements located elsewhere in this report.

Contractual Obligations

The following chart summarizes certain contractual obligations of the Company as of December 31, 2016 (dollars in thousands):

Contractual Obligations	Less than 1 Year	1-3 years	3-5 years	More than 5 years	Total
Operating lease obligations	$1,023	$1,976	$1,478	$1,874	$6,351
Supplemental retirement plans	60	196	316	2,190	2,762
Time deposit maturities	39,953	14,313	132	0	54,398
Total	$41,036	$16,485	$1,926	$4,064	$63,511

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

Liquidity and Asset/Liability Management

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

Liquidity

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

Since our deposit growth strategy emphasizes core deposit growth we have avoided relying on brokered deposits as a consistent source of funds. The only brokered deposit the Company holds are from CDARS and ICS, a certificate of deposit and money market program, respectively, that exchanges funds with other network banks to offer full FDIC insurance coverage to the customer. The Company had $50,000 and $1,001,000 in brokered deposits as of December 31, 2016 and 2015, respectively.

As a secondary source of liquidity, we rely on advances from the FHLB to supplement our supply of lendable funds and to meet deposit withdrawal requirements. Advances from the FHLB are typically secured by a portion of our loan portfolio and stock issued by the FHLB. The FHLB determines limitations on the amount of advances by assigning a percentage to each eligible loan category that will count towards the borrowing capacity. At December 31, 2016 and 2015, the Company had no FHLB advances outstanding and had sufficient collateral to borrow an additional $236.7 million and $198.4 million, respectively. In addition, the Company had lines of credit with its correspondent banks to purchase overnight federal funds totaling $43 million and $25 million at December 31, 2016 and 2015, respectively. No advances were made on these lines of credit as of December 31, 2016 and December 31, 2015.

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

Maintenance of adequate liquidity requires that sufficient resources be available at all time to meet our cash flow requirements. Liquidity in a banking institution is required primarily to provide for deposit withdrawals and the credit needs of its customers and to take advantage of investment opportunities as they arise. Liquidity management involves our ability to convert assets into cash or cash equivalents without incurring significant loss, and to raise cash or maintain funds without incurring excessive additional cost. For this purpose, we maintain a portion of our funds in cash and cash equivalents, loans and securities available for sale. Our liquid assets at December 31, 2016 and 2015 totaled approximately $269.7 million and $269.5 million, respectively. Our liquidity level measured as the percentage of liquid assets to total assets was 26.9% and 30.0% at December 31, 2016, and 2015, respectively.

Capital Resources and Capital Adequacy Requirements

In the past two years, our primary source of capital has been internally generated operating income through retained earnings. At December 31, 2016, total shareholders' equity increased to $82.5 million, representing an increase of $4.2 million from December 31, 2015. The increase was due to net income of $7.7 million recorded to retained earnings, offset by common stock dividend payments totaling $1.9 million, and a comprehensive loss of $1.8 million, net of income taxes, due to the negative effect that rising treasury yields had on the unrealized market value adjustment of our available for sale investment portfolio during 2016. As of December 31, 2016, we had no material commitments for capital expenditures.

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

As of December 31, 2016, we were qualified as a "well capitalized institution" under the regulatory framework for prompt corrective action. The following table presents the regulatory standards for well-capitalized institutions, compared to the Bank's capital ratios as of the dates specified:

	Regulatory Well-Capitalized Standards		**December 31, 2016**		**December 31, 2015**	
Total capital to risk-weighted assets	10.0	%	11.3	%	12.1	%
Tier I capital to risk-weighted assets	8.0	%	10.2	%	10.9	%
Common equity tier 1 risk-weighted assets	6.5	%	10.2	%	10.9	%
Tier I capital to average assets	5.0	%	8.1	%	9.0	%

The December 31, 2015 capital ratios reported above have been revised for the Tier 1 capital net reduction of $1,278,000 as a result of the increase of $2,651,000 to goodwill. See Footnote 2 and 21 to our 2016 year-end consolidated financial statements located elsewhere in this report for further discussion of the goodwill adjustment.

Market Risk

Market risk is the risk of loss of future earnings, fair values, or future cash flows that may result from changes in the price of a financial instrument. The value of a financial instrument may change as a result of changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market risk sensitive instruments. Market risk is attributed to all market risk sensitive financial instruments, including securities, loans, deposits and borrowings, as well as the Company's role as a financial intermediary in customer-related transactions. The objective of market risk management is to avoid excessive exposure of the Company's earnings and equity to loss and to reduce the volatility inherent in certain financial instruments.

Interest Rate Management

Market risk arises from changes in interest rates, exchange rates, commodity prices and equity prices. The Company's market risk exposure is primarily that of interest rate risk, and it has established policies and procedures to monitor and limit earnings and balance sheet exposure to changes in interest rates. The Company does not engage in the trading of financial instruments, nor does the Company have exposure to currency exchange rates.

The principal objective of interest rate risk management (often referred to as "asset/liability management") is to manage the financial components of the Company in a manner that will optimize the risk/reward equation for earnings and capital in relation to changing interest rates. The Company's exposure to market risk is reviewed on a regular basis by the Asset/Liability Committee. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income. Management realizes certain risks are inherent, and that the goal is to identify and manage the risks. Management uses two methodologies to manage interest rate risk: (i) a standard GAP analysis; and (ii) an interest rate shock simulation model.

The planning of asset and liability maturities is an integral part of the management of an institution's net interest margin. To the extent maturities of assets and liabilities do not match in a changing interest rate environment, the net interest margin may change over time. Even with perfectly matched repricing of assets and liabilities, risks remain in the form of prepayment of loans or securities or in the form of delays in the adjustment of rates of interest applying to either earning assets with floating rates or to interest bearing liabilities. The Company has generally been able to control its exposure to changing interest rates by maintaining primarily floating interest rate loans and a majority of its time certificates with relatively short maturities.

Interest rate changes do not affect all categories of assets and liabilities equally or at the same time. Varying interest rate environments can create unexpected changes in prepayment levels of assets and liabilities, which may have a significant effect on the net interest margin and are not reflected in the interest sensitivity analysis table. Because of these factors, an interest sensitivity gap report may not provide a complete assessment of the exposure to changes in interest rates.

The Company uses modeling software for asset/liability management in order to simulate the effects of potential interest rate changes on the Company's net interest margin, and to calculate the estimated fair values of the Company's financial instruments under different interest rate scenarios. The program imports current balances, interest rates, maturity dates and repricing information for individual financial instruments, and incorporates assumptions on the characteristics of embedded options along with pricing and duration for new volumes to project the effects of a given interest rate change on the Company's interest income and interest expense. Rate scenarios consisting of key rate and yield curve projections are run against the Company's investment, loan, deposit and borrowed funds portfolios. These rate projections can be shocked (an immediate and parallel change in all base rates, up or down) and ramped (an incremental increase or decrease in rates over a specified time period), based on current trends and econometric models or stable economic conditions (unchanged from current actual levels).

The Company applies a market value ("MV") methodology to gauge its interest rate risk exposure as derived from its simulation model. Generally, MV is the discounted present value of the difference between incoming cash flows on interest-earning assets and other investments and outgoing cash flows on interest-bearing liabilities and other liabilities. The application of the methodology attempts to quantify interest rate risk as the change in the MV which would result from a theoretical 200 basis point (1 basis point equals 0.01%) change in market interest rates. Both a 200 basis point increase and a 200 basis point decrease in market rates are considered for the purpose of the table below. Additionally, management evaluates shocked and ramped scenarios for interest rate changes up to 400 basis points.

At December 31, 2016, it was estimated that the Company's MV would decrease 12.8% in the event of an immediate 200 basis point increase in market interest rates. The Company's MV at the same date would decrease 25.8% in the event of an immediate 200 basis point decrease in applicable interest rates.

Presented below, as of December 31, 2016 and 2015, is an analysis of the Company's interest rate risk as measured by changes in MV for instantaneous and sustained parallel shifts of applicable interest rates:

	December 31, 2016		**Market Value as a % of Present Value of Assets**		**December 31, 2015**		**Market Value as a % of Present Value of Assets**	
	$ Change in Market Value	**% Change in Market Value**	**MV Ratio**	**Change (bp)**	**$ Change in Market Value**	**% Change in Market Value**	**MV Ratio**	**Change (bp)**
				(Dollars in Thousands)				
Shock Scenario								
+200 bp	$(25,356)	(12.97)%	17.50%	(182)	$(22,458)	(12.88)%	17.47%	(181)
+100 bp	$(11,029)	(5.64)%	18.60%	(72)	$(10,089)	(5.79)%	18.53%	(75)
0 bp	$0	0.00 %	19.32%	0	$0	0.00 %	19.28%	0
-100 bp	$(19,951)	(10.21)%	17.02%	(230)	$(20,851)	(11.96)%	16.67%	(261)
-200 bp	$(50,287)	(25.73)%	13.92%	(540)	$(50,759)	(29.12)%	13.31%	(597)

Management believes that the MV methodology overcomes three shortcomings of the typical maturity gap methodology. First, it does not use arbitrary repricing intervals and accounts for all expected future cash flows. Second, because the MV method projects cash flows of each financial instrument under different interest rate environments, it can incorporate the effect of embedded options on an institution's interest rate risk exposure. Third, it allows interest rates on different instruments to change by varying amounts in response to a change in market interest rates, resulting in more accurate estimates of cash flows.

However, as with any method of gauging interest rate risk, there are certain shortcomings inherent to the MV methodology. The model assumes interest rate changes are instantaneous parallel shifts in the yield curve. In reality, rate changes are rarely instantaneous. The use of the simplifying assumption that short-term and long-term rates change by the same degree may also misstate historic rate patterns, which rarely show parallel yield curve shifts. Further, the model assumes that certain assets and liabilities of similar maturity or period to repricing will react in the same way to changes in rates. In reality, certain types of financial instruments may react in advance of changes in market rates, while the reaction of other types of financial instruments may lag behind the change in general market rates. When interest rates change, actual loan prepayments and actual early withdrawals from certificates may deviate significantly from the assumptions used in the model. Finally, this methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan clients' ability to service their debt. All of these factors are considered in monitoring the Company's exposure to interest rate risk.

Impact of Inflation; Seasonality

Inflation primarily impacts us by its effect on interest rates. Our primary source of income is net interest income, which is affected by changes in interest rates. We attempt to limit the impact of inflation on our net interest margin through management of rate-sensitive assets and liabilities and the analysis of interest rate sensitivity. The effect of inflation on premises and equipment as well as noninterest expenses has not been significant for the periods covered in this report. Our business is generally not seasonal.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not required.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements and the Independent Auditors' Report appear on pages F-1 through F-49 of this Report and are incorporated into this Item 8 by reference.

INDEX TO FINANCIAL STATEMENTS

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We conducted an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the 1934 Act as of December 31, 2016. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2016.

The term disclosure controls and procedures means controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the 1934 Act (15 U.S.C. 78a et seq.) is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Act is accumulated and communicated to our Management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There are inherent limitations to the effectiveness of any system of disclosure controls and procedures. These limitations include the possibility of human error, the circumvention or overriding of the controls and procedures and reasonable resource constraints. In addition, because we have designed our system of controls based on certain assumptions, which we believe are reasonable, about the likelihood of future events, our system of controls may not achieve its desired purpose under all possible future conditions. Accordingly, our disclosure controls and procedures provide reasonable assurance, but not absolute assurance, of achieving their objectives.

Management's Annual Report on Internal Control over Financial Reporting

Our Management's report on Internal Control over Financial Reporting is set forth in Item 8 and is incorporated herein by reference.

Our internal control over financial reporting is designed to provide reasonable, but not absolute, assurance regarding the financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. There are inherent limitations to the effectiveness of any system of internal control over financial reporting. These limitations include the possibility of human error, the circumvention of overriding of the system and reasonable resource constraints. Because of its inherent limitations, our internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

This annual report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's independent registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the quarter ended December 31, 2016 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated by reference from our Proxy Statement to be filed prior to the 2017 Annual Meeting of Shareholders. The Company and the Company have adopted a Code of Ethics that applies to all staff including the Chief Executive Officer, and the Chief Financial Officer. A copy of the Code of Ethics will be provided to any person, without charge, upon written request to Corporate Secretary, Oak Valley Bancorp, 125 North Third Avenue, Oakdale, CA 95361.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the 1934 Act requires the Company's officers and directors, and persons who own more than 10% of a registered class of the Company's equity securities, to file reports of ownership and changes in ownership with the SEC. Officers, directors and greater than 10% shareholders are required by SEC regulations to furnish the Company with copies of all Section 16(a) forms they file.

Based solely on its review of the copies of such forms received by it, or written representations from certain reporting persons that no Forms 4 and 5 were required for those persons, the Company believes that for the 2016 fiscal year the officers and directors of the Company complied with all applicable filing requirements, except for the late filings for the directors in the table below:

Name	Form	Transaction Type	Transaction Date	# of Shares
Tom Haidlen	4	Purchase (1)	2/11/2016	183
James Gilbert	4	Purchase (1)	2/12/2016	347
Tom Haidlen	4	Purchase (1)	8/11/2016	182
James Gilbert	4	Purchase (1)	8/12/2016	343
H. Randolph Holder, Jr.	4	Purchase	2/22/2016	5,794
H. Randolph Holder, Jr.	4	Purchase	2/25/2016	49
H. Randolph Holder, Jr.	4	Purchase	2/29/2016	23
Michael Jones	4	Purchase	2/3/2016	128
Michael Jones	4	Purchase	2/3/2016	118
Michael Jones	4	Purchase	2/3/2016	900
Michael Jones	4	Purchase	4/25/2016	3,528
Terry Withrow	4	Purchase (1)	2/12/2016	176

(1) Automatic Reinvestment of Cash Dividend

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference from our Proxy Statement to be filed prior to the 2017 Annual Meeting of Shareholders.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item is incorporated by reference from our Proxy Statement to be filed prior to the 2017 Annual Meeting of Shareholders.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated by reference from our Proxy Statement to be filed prior to the 2017 Annual Meeting of Shareholders.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item is incorporated by reference from our Proxy Statement to be filed prior to the 2017 Annual Meeting of Shareholders.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

Documents Filed as Part of this Report:

(a)(1) Financial Statements

The Financial Statements of the Company and the Report of Independent Registered Public Accounting Firm are set forth on pages F-1 through F-49.

(a)(2) Financial Statement Schedules

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

(a)(3) Exhibits

The exhibit list required by this Item is incorporated by reference to the Exhibit Index included in this report. The warranties, representations and covenants contained in any of the agreements included herein or which appear as exhibits hereto should not be relied upon by buyers, sellers or holders of the Company's securities and are not intended as warranties, representations or covenants to any individual or entity except as specifically set forth in such agreement.

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, (the "1934 Act") the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in Oakdale, California on March 21, 2017.

OAK VALLEY BANCORP
a California corporation

By:	/s/ CHRISTOPHER M. COURTNEY Christopher M. Courtney, *President and Chief Executive Officer*

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

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each of the undersigned officers and directors of the registrant hereby constitutes and appoints Christopher M. Courtney and Jeffrey A. Gall, and each of them, as lawful attorney-in-fact and agent for each of the undersigned (with full power of substitution and resubstitution, for and in the name, place and stead of each of the undersigned officers and directors), to sign and file with the Securities and Exchange Commission under the 1934 Act any and all amendments, supplements and exhibits to this report and any and all other documents in connection therewith, hereby granting unto said attorneys-in-fact, and each of them, full power and authority to do and perform each and every act and thing necessary or desirable to be done in order to effectuate the same as fully and to all intents and purposes as each of the undersigned might or could do if personally present, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or any of their substitutes, may do or cause to be done by virtue hereof.

Signature	**Title**	**Date**
/s/ DONALD L. BARTON	Director	March 21, 2017

Donald Barton

/s/ CHRISTOPHER M. COURTNEY Christopher M. Courtney	President, Chief Executive Officer and Director (Principal Executive Officer)	March 21, 2017
/s/ JEFFREY A. GALL Jeffrey A. Gall	Chief Financial Officer (Principal Financial and Principal Accounting Officer)	March 21, 2017
/s/ JAMES L. GILBERT James L. Gilbert	Director	March 21, 2017
/s/ THOMAS A. HAIDLEN Thomas A. Haidlen	Director	March 21, 2017
/s/ H. RANDOLPH HOLDER H. Randolph Holder	Director	March 21, 2017
/s/ MICHAEL Q. JONES Michael Q. Jones	Director	March 21, 2017
/s/ DANIEL J. LEONARD Daniel J. Leonard	Director	March 21, 2017

/s/ RONALD C. MARTIN Ronald C. Martin	Director	March 21, 2017
/s/ JANET S. PELTON Janet S. Pelton	Director	March 21, 2017
/s/ DANNY L. TITUS Danny L. Titus	Director	March 21, 2017
/s/ TERRANCE P. WITHROW Terrance P. Withrow	Director	March 21, 2017

Management's Assessment of Internal Control over Financial Reporting

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed under the supervision of the Company's Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

As of December 31, 2016, management assessed the effectiveness of the Company's internal control over financial reporting based on the criteria for effective internal control over financial reporting established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 COSO) and guidance issued by the Securities and Exchange Commission. Based on the assessment, management determined that the Company maintained effective internal control over financial reporting as of December 31, 2016, based on those criteria.

The Company's management, including its Chief Executive Officer and Chief Financial Officer, does not expect that its disclosure controls and procedures, or its internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefit of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

/s/ CHRISTOPHER M. COURTNEY

Christopher M. Courtney, *President and Chief Executive Officer*

/s/ JEFFREY A. GALL

Jeffrey A. Gall, *Chief Financial Officer*

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders

Oak Valley Bancorp

We have audited the accompanying consolidated balance sheets of Oak Valley Bancorp and subsidiary (the "Company") as of December 31, 2016 and 2015 and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for the years ended December 31, 2016 and 2015. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Oak Valley Bancorp and subsidiary as of December 31, 2016 and 2015, and the consolidated results of their operations and their cash flows for the years ended December 31, 2016 and 2015 in conformity with accounting principles generally accepted in the United States of America.

/s/ Moss Adams LLP

Los Angeles, California

March 24, 2017

OAK VALLEY BANCORP

CONSOLIDATED BALANCE SHEETS

(dollars in thousands)	December 31, 2016	December 31, 2015
ASSETS		
Cash and due from banks	$179,025	$174,778
Federal funds sold	11,785	15,825
Cash and cash equivalents	190,810	190,603
Securities available for sale	160,333	131,546
Loans, net of allowance for loan loss of $7,832 and $7,356 at December 31, 2016 and 2015, respectively	601,104	530,394
Bank premises and equipment, net	13,688	14,277
Other real estate owned	1,210	2,066
Interest receivable and other assets	34,965	28,152
	$1,002,110	$897,038
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits	$914,093	$814,691
Interest payable and other liabilities	5,567	4,084
Total liabilities	919,660	818,775
Commitments and contingencies (Note 14)		
Shareholders' equity		
Common stock, no par value; 50,000,000 shares authorized, 8,088,455 and 8,078,155 shares issued and outstanding at December 31, 2016 and 2015, respectively	24,682	24,682
Additional paid-in capital	3,473	3,217
Retained earnings	54,520	48,795
Accumulated other comprehensive (loss) income, net of tax	(225)	1,569
Total shareholders' equity	82,450	78,263
	$1,002,110	$897,038

See accompanying notes

OAK VALLEY BANCORP

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share amounts)	YEAR ENDED DECEMBER 31, 2016	2015
INTEREST INCOME		
Interest and fees on loans	$27,463	$22,053
Interest on securities available for sale	4,124	3,629
Interest on federal funds sold	35	34
Interest on deposits with banks	667	304
Total interest income	32,289	26,020
INTEREST EXPENSE		
Deposits	764	615
Total interest expense	764	615
Net interest income	31,525	25,405
Provision for (reversal of) for loan losses	484	(125)
Net interest income after provision for (reversal of) loan losses	31,041	25,530
OTHER INCOME		
Service charges on deposits	1,354	1,240
Earnings on cash surrender value of life insurance	441	429
Mortgage commissions	204	148
Gains on called securities	52	206
Other	2,362	2,084
Total non-interest income	4,413	4,107
OTHER EXPENSES		
Salaries and employee benefits	13,564	11,717
Occupancy expenses	3,284	3,009
Data processing fees	1,604	1,466
Regulatory assessments (FDIC & DBO)	643	506
Other operating expenses	5,220	5,977
Total non-interest expense	24,315	22,675
Net income before provision for income taxes	11,139	6,962
PROVISION FOR INCOME TAXES	3,474	2,054
NET INCOME	$7,665	$4,908
NET INCOME PER COMMON SHARE	$0.95	$0.61

NET INCOME PER DILUTED COMMON SHARE	$0.95	$0.61

See accompanying notes

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OAK VALLEY BANCORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)	YEAR ENDED DECEMBER 31, 2016	2015
Net income	$7,665	$4,908
Other comprehensive loss:		
Unrealized holding losses on securities arising during the current period, net of tax effect of ($1,233) thousand and ($124) thousand for the years ended December 31, 2016 and 2015, respectively	(1,763)	(177)
Reclassification adjustment due to net gains realized on calls of securities, net of tax effect of $21 thousand and $85 thousand for the years ended December 31, 2016 and 2015, respectively	(31)	(121)
Other comprehensive loss	(1,794)	(298)
Comprehensive income	$5,871	$4,610

See accompanying notes

OAK VALLEY BANCORP

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

YEAR ENDED DECEMBER 31, 2016 AND 2015

(dollars in thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, January 1, 2015	8,074,855	$24,682	$ 2,910	$45,582	$ 1,867	$ 75,041
Stock options exercised						0
Tax benefit on stock based compensation			46			46
Restricted stock issued	6,000					0
Restricted stock forfeited	(2,700)					0
Cash dividends declared				(1,695)		(1,695)
Stock based compensation			261			261
Other comprehensive loss					(298)	(298)
Net income				4,908		4,908
Balances, December 31, 2015	8,078,155	$24,682	$ 3,217	$48,795	$ 1,569	$ 78,263
Restricted stock issued	17,000					$ 0
Restricted stock forfeited	(6,700)					0
Cash dividends declared				(1,940)		(1,940)
Stock based compensation			256			256
Other comprehensive loss					(1,794)	(1,794)
Net income				7,665		7,665
Balances, December 31, 2016	8,088,455	$24,682	$ 3,473	$54,520	$ (225)	$ 82,450

See accompanying notes

OAK VALLEY BANCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)	YEAR ENDED DECEMBER 31, 2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$7,665	$4,908
Adjustments to reconcile net earnings to net cash from operating activities:		
Provision for (reversal of) loan losses	484	(125)
Decrease in deferred fees/costs, net	(19)	(124)
Depreciation	1,252	1,207
Amortization of investment securities, net	409	188
Stock based compensation	256	261
Excess tax benefits from vested restricted stock awards	0	(46)
Gain on sale of premises and equipment	(4)	(5)
OREO loss on sales and write downs	96	50
Gain on sales and calls of available for sale securities	(52)	(206)
Earnings on cash surrender value of life insurance	(441)	(429)
(Increase) decrease in deferred tax asset	(687)	35
Gain on BOLI death benefit	(2)	(66)
Increase (decrease) in interest payable and other liabilities	1,483	(1,214)
Increase in interest receivable	(411)	(33)
Increase in other assets	(123)	(90)
Net cash from operating activities	9,906	4,311
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available for sale securities	(53,955)	(42,694)
Proceeds from maturities, calls, and principal paydowns of securities available for sale	21,762	31,935
Net increase in loans	(71,428)	(41,778)
Purchase of FHLB Stock	(79)	(142)
Purchase of BOLI policies	(4,000)	0
Proceeds from sale of OREO	1,012	0
Proceeds from redemption of BOLI policies	186	292
Cash acquired from acquisitions, net of cash paid	0	23,468
Proceeds from sales of premises and equipment	4	5
Net purchases of premises and equipment	(663)	(1,418)
Net cash used in investing activities	(107,161)	(30,332)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Shareholder cash dividends paid	(1,940)	(1,695)
Net increase in demand deposits and savings accounts	95,578	77,313
Net decrease in time deposits	3,824	(3,328)
Excess tax benefits from vested restricted stock awards	0	46

Net cash from financing activities	97,462	72,336
NET INCREASE IN CASH AND CASH EQUIVALENTS	207	46,315
CASH AND CASH EQUIVALENTS, beginning of period	190,603	144,288
CASH AND CASH EQUIVALENTS, end of period	$190,810	$190,603
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$756	$618
Income taxes	$2,331	$4,152
NON-CASH INVESTING ACTIVITIES:		
Real estate acquired through foreclosure	$253	$956
Change in unrealized loss on available-for-sale securities	$(3,048)	$(507)
Acquisitions:		
Fair value of assets acquired	$NA	$78,717
Fair value of liabilities assumed	$NA	$71,381

See accompanying notes

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OAK VALLEY BANCORP

NOTES TO FINANCIAL STATEMENTS

NOTE 1 — SUMMARY OF ACCOUNTING POLICIES

Nature of Operations

On July 3, 2008 (the “Effective Date”), a bank holding company reorganization was completed whereby Oak Valley Bancorp (“Bancorp”) became the parent holding company for Oak Valley Community Bank (the “Bank”). On the Effective Date, a tax-free exchange was completed whereby each outstanding share of the Company was converted into one share of Bancorp and the Company became the sole wholly-owned subsidiary of the holding company.

The consolidated financial statements include the accounts of Bancorp and its wholly-owned bank subsidiary. All material intercompany transactions have been eliminated. In the opinion of Management, the consolidated financial statements contain all adjustments necessary to present fairly the financial position, results of operations, changes in shareholders’ equity and cash flows. All adjustments are of a normal, recurring nature.

Oak Valley Community Bank is a California State chartered bank. The Company was incorporated under the laws of the state of California on May 31, 1990, and began operations in Oakdale on May 28, 1991. The Company operates branches in Oakdale, Sonora, Bridgeport, Bishop, Mammoth Lakes, Modesto, Manteca, Patterson, Turlock, Ripon, Stockton, and Escalon, California. The Bridgeport, Mammoth Lakes, and Bishop branches operate as a separate division, Eastern Sierra Community Bank. The Company’s primary source of revenue is providing loans to customers who are predominantly middle-market businesses.

On December 23, 2015, the Company completed its acquisition of Mother Lode Bank (“MLB”), a California state-chartered bank headquartered in Sonora, California, in a transaction in which Mother Lode Bank was merged with and into the Bank, with the Bank as the surviving company in the transaction (Note 2). The purchase price for Mother Lode Bank was approximately $7.3 million.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant accounting estimates reflected in the Company’s consolidated financial statements include the allowance for loan losses, accounting for income taxes, fair value measurements, and the determination, recognition and measurement of impaired loans. Actual results could differ from these estimates.

A summary of the significant accounting policies applied in the preparation of the accompanying consolidated financial statements follows.

Subsequent events — The Company has evaluated events and transactions subsequent to December 31, 2016for potential recognition or disclosure.

Cash and cash equivalents — The Company has defined cash and cash equivalents to include cash, due from banks, certificates of deposit with original maturities of three months or less, and federal funds sold. Generally, federal funds are sold for one-day periods. At times throughout the year, balances can exceed FDIC insurance limits.

Securities available for sale — Available-for-sale securities consist of bonds, notes, and debentures not classified as trading securities or held-to-maturity securities. Available-for-sale securities with unrealized holding gains and losses are reported as an amount in accumulated other comprehensive income, net of tax. Gains and losses on the sale of available-for-sale securities are determined using the specific identification method. The amortization of premiums and accretion of discounts are recognized as adjustments to interest income over the period to maturity.

Investments with fair values that are less than amortized cost are considered impaired. Impairment may result from either a decline in the financial condition of the issuing entity or, in the case of fixed interest rate investments, from rising interest rates. At each consolidated financial statement date, management assesses each investment to determine if impaired investments are temporarily impaired or if the impairment is other than temporary. This assessment includes a determination of whether the Company intends to sell the security, or if it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other than temporarily impaired and that the Company does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, the amount of impairment is separated into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is calculated as the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of the future expected cash flows is deemed to be due to factors that are not credit related and is recognized in other comprehensive income. If the Company sold an impaired security, both the credit loss component and amount due to other factors would be recognized through earnings as described above.

Other real estate owned — Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value of the property at the date of foreclosure less estimated selling costs. Subsequent to foreclosure, valuations are periodically performed and any subject revisions in the estimate of fair value are reported as adjustment to the carrying value of the real estate, provided the adjusted carrying amount does not exceed the original amount at foreclosure. Revenues and expenses from operations and changes in the valuation allowance are included in other operating expenses.

Loans originated — Loans are reported at the principal amount outstanding, net of unearned income, deferred loan fees, and the allowance for loan losses. Unearned discounts on installment loans are recognized as income over the terms of the loans. Interest on other loans is calculated by using the simple interest method on the daily balance of the principal amount outstanding.

Loan fees net of certain direct costs of origination are deferred and amortized, as an adjustment to interest yield, over the estimated life of the loan.

Loans on which the accrual of interest has been discontinued are designated as non-accrual loans. Accrual of interest on loans is discontinued either when reasonable doubt exists as to the full and timely collection of interest or principal or when a loan becomes contractually past due by ninety days or more with respect to interest or principal. When a loan is placed on non-accrual status, all interest previously accrued, but not collected, is reversed against current period interest income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

Allowance for loan losses — The allowance for loan losses is established through a provision for loan losses charged to operations. Loans are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. Subsequent recoveries of previously charged off amounts, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based on management’s periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additional allowance based on their judgment about information available to them at the time of their examination.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. Impaired loans, as defined, are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. The general component relates to non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

The Company considers a loan impaired when it is probable that all amounts of principal and interest due, according to the contractual terms of the loan agreement, will not be collected. Interest income is recognized on impaired loans in the same manner as non-accrual loans. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

The method for calculating the allowance for unfunded loan commitments is based on an allowance percentage which is less than other outstanding loan types because they are at a lower risk level. This allowance percentage is evaluated by management periodically and is applied to the total undisbursed loan commitment balance to calculate the allowance for off-balance-sheet commitments.

The Company considers a loan to be a troubled debt restructure ("TDR") when the Company has granted a concession and the borrower is experiencing financial difficulty. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company's internal underwriting policy. A TDR loan is kept on non-accrual status until the borrower has paid for six consecutive months with no payment defaults, at which time the TDR is placed back on accrual status. A TDR loan is impaired and a specific valuation allowance is allocated, if necessary, so that the TDR loan is reported net, at the present value of estimated future cash flows using the TDR loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

Acquired Loans and Leases — Loans and leases acquired through purchase or through a business combination are recorded at their fair value at the acquisition date. Credit discounts, which reflect estimates of credit losses, expected to be incurred over the life of the loan, are included in the determination of fair value; therefore, an allowance for loan and lease losses is not recorded at the acquisition date.

Acquired loans are evaluated upon acquisition for evidence of deterioration in credit quality since their origination to determine if it is probable the Company will be unable to collect all contractually required payments. These loans are classified as Purchased Credit Impaired ("PCI") loans, while all other acquired loans are classified as non-PCI loans. The Company has elected to account for PCI loans at the individual loan level. The Company estimates the amount and timing of expected cash flows for each loan. The expected cash flow in excess of the loan's carrying value, is referred to as the accretable yield, and is recorded as interest income over the remaining expected life of the loan. The excess of the loan's contractual principal and interest over expected cash flows is referred to as the non-accretable difference, and is representative of contractual amounts the Company does not expect to collect. The non-accretable difference is not recorded in the Company's consolidated financial statements.

Quarterly, management performs an evaluation of expected future cash flows for PCI loans. If current expectations of future cash flows are less than management's previous expectations, other than due to decreases in interest rates and prepayment assumptions, an allowance for loan and leases losses is recorded with a charge to provision for loan and lease losses. If there has been a probable and significant increase in expected future cash flows over that which was previously expected, the Company first reduces any previously established allowance for loan and lease losses, and then records an adjustment to interest income through a prospective increase in the accretable yield.

For acquired loans not considered credit impaired ("non-PCI"), we recognize the entire fair value discount accretion to interest income, based on contractual cash flows using an effective interest rate method for term loans, and on a straight line basis for revolving lines. When a non-PCI loan is placed on non-accrual status subsequent to acquisition, accretion stops until the loan is returned to accrual status. The level of accretion on non-PCI loans varies from period to period due to maturities and early pay-offs of these loans during the reporting periods. Subsequent to acquisition, if the probable and estimable losses for non-PCI loans exceed the amount of the remaining unaccreted discount, the excess is established as an allowance for loan losses. All acquired loans were acquired in acquisitions and do not represent loans purchased from third parties.

Premises and equipment — Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives using the straight-line basis. The estimated lives used in determining depreciation and amortization are:

Building (in years)		31.5	
Equipment (in years)	3	–	12
Furniture and fixtures (in years)	3	–	7
Leasehold improvements (in years)	5	–	15
Automobiles (in years)	3	–	5

Leasehold improvements are amortized over the lesser of the useful life of the asset or the remaining term of the lease. The straight-line method of depreciation is followed for all assets for financial reporting purposes, but accelerated methods are used for tax purposes. Deferred income taxes have been provided for the resulting temporary differences.

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

The Company files income tax returns in the U.S. federal jurisdiction, and the state of California. With few exceptions, the Company is no longer subject to U.S. federal tax examinations by tax authorities for years before 2013 or to state/local income tax examinations by tax authorities for years before 2012.

Transfers of financial assets — Transfers of an entire financial asset, a group of financial assets, or a participating interest in an entire financial asset are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that contain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Advertising costs — The Company expenses marketing costs as they are incurred. Advertising expense was $199,000 and $189,000 for the years ended December 31, 2016 and 2015, respectively.

Comprehensive income — Comprehensive income is comprised of net income and other comprehensive income (loss). Other comprehensive income (loss) includes items previously recorded directly to equity, such as unrealized gains and losses on securities available for sale. Comprehensive income is presented in the statements of comprehensive income and as a component of shareholders' equity. For the years ended December 31, 2016 and 2015, $31,000 and $121,000 net of tax, respectively, was reclassified from comprehensive income into net income related to gains on called and sold available for sale securities.

Federal Reserve Bank Stock — Federal Reserve Bank stock represents the Company's investment in the stock of the Federal Reserve Bank ("FRB") and is carried at par value, which reasonably approximates its fair value. While technically these are considered equity securities, there is no market for the FRB stock. Therefore, the shares are considered as restricted investment securities. Management periodically evaluates FRB stock for other-than-temporary impairment. Management's determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FRB as compared to the capital stock amount for the FRB and the length of time this situation has persisted, (2) commitments by the FRB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FRB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FRB, and (4) the liquidity position of the FRB. This investment is reflected as a component of interest receivable and other assets on the consolidated balance sheets.

Federal Home Loan Bank Stock — Federal Home Loan Bank stock represents the Company's investment in the stock of the Federal Home Loan Bank of San Francisco ("FHLB") and is carried at par value, which reasonably approximates its fair value. While technically these are considered equity securities, there is no market for the FHLB stock. Therefore, the shares are considered as restricted investment securities. Management periodically evaluates FHLB stock for other-than-temporary impairment. Management's determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB. This investment is reflected as a component of interest receivable and other assets on the consolidated balance sheets.

Earnings per common share ("EPS") — EPS is based upon the weighted average number of common shares outstanding during each year. The table in footnote 13 shows: (1) weighted average basic shares, (2) effect of dilutive securities related to stock options and non-vested restricted stock, and (3) weighted average diluted shares. Basic EPS are calculated by dividing net income by the weighted average number of common shares outstanding during each period, excluding dilutive stock options and unvested restricted stock awards. Diluted EPS are calculated using the weighted average diluted shares. The total dilutive shares included in annual diluted EPS is a year-to-date weighted average of the total dilutive shares included in each quarterly diluted EPS computation under the treasury stock method. We have two forms of outstanding common stock: common stock and unvested restricted stock awards. Holders of restricted stock awards receive non-forfeitable dividends at the same rate as common stockholders and they both share equally in undistributed earnings. Therefore, under the two-class method, the difference in EPS is not significant for these participating securities.

Stock based compensation — The Company recognizes in the consolidated statements of income the grant-date fair value of stock options and other equity-based forms of compensation issued to employees over the employees' requisite service period (generally the vesting period). The Company uses the straight-line recognition of expenses for awards with graded vesting.

The fair value of each option grant is estimated as of the grant date using a binomial option-pricing model for all grants. Expected volatility is based on the historical volatility of the price of the Company's stock. The Company uses historical data to estimate option exercise and stock option forfeiture rates within the valuation model. The expected term of options granted for the binomial model is derived from applying a historical suboptimal exercise factor to the contractual term of the grant. For binomial pricing, the risk-free rate for periods is equal to the U.S. Treasury yield at the time of grant and commensurate with the contractual term of the grant. There were no stock options granted in 2016 or 2015.

Fair values of financial instruments — The consolidated financial statements include various estimated fair value information as of December 31, 2016 and 2015. Such information, which pertains to the Company's financial instruments, does not purport to represent the aggregate net fair value of the Company. Further, the fair value estimates are based on various assumptions, methodologies, and subjective considerations, which vary widely among different financial institutions and which are subject to change.

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

The Company has established and documented a process for determining fair value. The Company maximizes the use of observable inputs and minimizes the use of unobservable inputs when developing fair value measurements. Whenever there is no readily available market data, Management uses its best estimate and assumptions in determining fair value, but these estimates involve inherent uncertainties and the application of Management's judgment. As a result, if other assumptions had been used, our recorded earnings or disclosures could have been materially different from those reflected in these financial consolidated statements.

Reclassifications — Certain prior year amounts have been reclassified to conform to the current year presentation. See Note 2. There was no effect on net income or shareholders' equity as a result of reclassifications.

Business combinations and related matters — Business combinations are accounted for under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*. Under the acquisition method the acquiring entity in a business combination recognizes 100 percent of the acquired assets and assumed liabilities, regardless of the percentage owned, at their estimated fair values as of the date of acquisition. Any excess of the purchase price over the fair value of net assets and other identifiable intangible assets acquired is recorded as goodwill. Assets acquired and liabilities assumed from contingencies must also be recognized at fair value, if the fair value can be determined during the measurement period. Results of operations of an acquired business are included in the statement of operations from the date of acquisition. Acquisition-related costs, including conversion charges, are expensed as incurred. The Company applied this guidance to the acquisition of Mother Lode Bank that was consummated on December 23, 2015. The Company's consolidated financial statements for the year ended December 31, 2015 reflect the operations of Mother Lode Bank from December 24, 2015 through December 31, 2015.

Goodwill and other intangible assets — Intangible assets are comprised of goodwill and core deposit intangibles acquired in the Mother Lode Bank Acquisition. Intangible assets with definite useful lives are amortized over their respective estimated useful lives. If an event occurs that indicates the carrying amount of an intangible asset may not be recoverable, management reviews the asset for impairment. Any goodwill and any intangible asset acquired in a purchase business combination determined to have an indefinite useful life is not amortized, but is evaluated for impairment, at a minimum, on an annual basis.

The Company applies a qualitative analysis of conditions in order to determine if it is more likely than not that the carrying value is impaired. In the event that the qualitative analysis suggests that the carrying value of goodwill may be impaired, the Company, with the assistance of an independent third party valuation firm, uses several quantitative valuation methodologies in evaluating goodwill for impairment including a discounted cash flow approach that includes assumptions made concerning the future earnings potential of the organization, and a market-based approach that looks at values for organizations of comparable size, structure and business model. The current year's review of qualitative factors did not indicate that impairment has occurred, as such no quantitative analysis was performed at December 31, 2016.

Recently Issued Accounting Standards —

In September, 2015, the FASB issued ASU No. 2015-16, *Simplifying the Accounting for Measurement Period Adjustments (Topic 805).* This ASU eliminates the requirement to restate prior period financial statements for measurement period adjustments to assets acquired and liabilities assumed in a business combination. The new guidance under this update requires the cumulative impact of measurement period adjustments be recognized in the period the adjustment is determined. This update does not change what constitutes a measurement period adjustment, nor does it change the length of the measurement period. The new standard is effective for interim annual periods beginning after December 15, 2015 and should be applied prospectively to measurement period adjustments that occur after the effective date. The adoption of this update is not expected to have a material impact on the Company's consolidated financial statements.

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

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

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

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

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

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

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

ASU 2016-01 is effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. This ASU will impact our financial statement disclosures, however, we do not expect this ASU to have a material impact on our financial condition or results of operations.

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

In March 2016, FASB issued ASU 2016-09, *Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.* The amendments in ASU 2016-09 simplify several aspects of the accounting for share-based payment award transactions, including: (a) income tax consequences; (b) classification of awards as either equity or liabilities; and (c) classification on the statement of cash flows. The amendments are effective for public companies for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any interim or annual period. The Company adopted this ASU for the full fiscal year of 2016 and it did not have a significant impact on its consolidated financial statements.

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

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows – Classification of Certain Cash Receipts and Cash Payments (Topic 230).* This update clarifies how entities should classify certain cash receipts and cash payments on the statement of cash flows with the objective of reducing the existing diversity in practice related to eight specific cash flow issues. The amendments in this update are effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. The Company does not expect the adoption of the amendments within this update will have a material impact on the Company’s financial statements.

In January 2017, FASB issued ASU 2017-03, *Accounting Changes and Error Corrections (Topic 250) and Investments - Equity Method and Joint Ventures (Topic 323): Amendments to SEC Paragraphs Pursuant to Staff Announcements at the September 22, 2016 and November 17, 2016 EITF Meetings.* These amendments apply to ASU 2014-9 (Revenue from Contracts with Customers), ASU 2016-02 (Leases), and ASU 2016-13 (Financial Instruments - Credit Losses). The Company does not expect these amendments to have a significant impact on its consolidated financial statements.

NOTE 2 – BUSINESS COMBINATION

On December 23, 2015, in effort to expand our market presence and enhance shareholder value, the Company acquired Mother Lode Bank ("MLB"), via a merger with and into the Bank, upon the consummation of which all outstanding common shares and unexercised options to purchase MLB common stock were cancelled, in exchange for $7,336,000 in cash (the "MLB Acquisition"). On January 29, 2016, the two acquired MLB branches in Sonora were closed after management determined that our two existing branches in Sonora would be able to support our acquired customers. The assets acquired and liabilities assumed, both tangible and intangible, were recorded at their fair values as of the acquisition date in accordance with ASC 805.

During the third quarter of 2016, the Company determined that deferred tax assets acquired from MLB totaling $2,651,000, mainly from net operating loss carryforwards, cannot be utilized by the Company. As a result, the Company decreased deferred tax assets and increased goodwill by $2,651,000 as of the December 23, 2015 acquisition date in the tables below. Additionally, all related financial statement disclosures have been revised. These revisions did not impact previously reported net income or shareholders equity.

The following table reflects the estimated fair values of the assets acquired and liabilities assumed related to the MLB Acquisition:

(Dollars in thousands)	Acquisition Date December 23, 2015
Assets:	
Cash and cash equivalents	$ 30,804
Loans	42,831
Core deposit intangible	1,031
Goodwill	3,313
Other assets	737
Total assets acquired	$ 78,717
Liabilities:	
Deposits:	
Non-interest bearing	$ 36,177
Interest bearing	
Transaction accounts	6,112
Savings accounts	15,727
Money market accounts	7,602
Other time accounts	5,507
Total deposits	71,125
Other liabilities	256
Total liabilities assumed	$ 71,381
Merger consideration	$ 7,336

The following table presents the net assets acquired from MLB and the estimated fair value adjustments:

(Dollars in thousands)	Acquisition Date December 23, 2015
Book value of net assets acquired from Mother Lode Bank	$ 4,884
Fair value adjustments:	
Loans	(2,960)
Reversal of Allowance for Loan Loss	1,279

Core deposit intangible asset	1,031
Other assets & liabilities, net	(211)
Total purchase accounting adjustments	$ (861)
Fair value of net assets acquired from Mother Lode Bank	$ 4,023
Merger consideration	7,336
Less: fair value of net assets acquired	(4,023)
Goodwill	$ 3,313

As a result of the MLB Acquisition, we recorded $3,313,000 in goodwill, which represents the excess of the total purchase price paid over the fair value of the assets acquired, net of the fair values of liabilities assumed. Goodwill mainly reflects expected value created through the combined operations of MLB and the Company. At December 31, 2016 and 2015, we determined that the fair value of our traditional community banking activities (provided through our branch network) exceeded the carrying amount. Therefore, no impairment on goodwill has been recorded. The following is a description of the methods used to determine the fair values of significant assets and liabilities at acquisition date presented above.

Loans

The fair values for acquired loans were developed based upon the present values of the expected cash flows utilizing market-derived discount rates. Expected cash flows for each acquired loan were projected based on contractual cash flows adjusted for expected prepayment, expected default (i.e. probability of default and loss severity), and principal recovery.

Prepayment rates were applied to the principal outstanding based on the type of loan, where appropriate. Prepayments were based on a constant prepayment rate (“CPR”) applied across the life of a loan. The annual CPRs were between 0% and 5%, depending on the characteristics of the loan pool (e.g. construction, commercial real estate, etc.).

Non-credit-impaired loans with similar characteristics were grouped together and were treated in the aggregate when applying the discount rate on the expected cash flows. Aggregation factors considered included the type of loan and related collateral, risk classification, fixed or variable interest rate, term of loan and whether or not the loan was amortizing. See Note 5 for additional information.

Core Deposit Intangible

The core deposit intangible represents the estimated future benefits of acquired deposits and is booked separately from the related deposits. The value of the core deposit intangible asset was determined using a discounted cash flow approach to arrive at the cost differential between the core deposits (non-maturity deposits such as transaction, savings and money market accounts) and alternative funding sources. The core deposit intangible is amortized on an accelerated basis over an estimated ten-year life, and it is evaluated periodically for impairment. No impairment loss was recognized as of December 31, 2016.

A core deposit intangible asset of $1,031,000 was recorded on December 23, 2015, none of which was amortized during 2015 and $159,000 was amortized during 2016. At December 31, 2016, the future estimated amortization expense is as follows:

(in thousands)	2017	2018	2019	2020	2021	Thereafter	Total
Core deposit intangible amortization	$129	$114	$105	$96	$93	$ 335	$872

Acquisition Related Expenses

Acquisition-related expenses are recognized as incurred and continue until all systems have been converted and operational functions become fully integrated. We incurred one-time third-party acquisition-related expenses in the consolidated statements of income totaling $173,000 and $1,971,000 during the years ended December 31, 2016 and 2015, respectively. The conversion of the operating systems was completed in April 2016.

Pro Forma Results of Operations

Included in the Company’s consolidated statement of income for the year ended December 31, 2015, was revenue of $64,000 and net income of $37,000 related to normal business operations of MLB. Management believes pro forma results of operations for the year ended December 31, 2015 would not have been significantly different had the MLB acquisition occurred on January 1, 2015.

Acquisition-related expenses are recognized as incurred and continue until all systems have been converted and operational functions become fully integrated. We incurred one-time third-party acquisition-related expenses in the consolidated statements of income in 2016 and 2015 as follows:

(Dollars in thousands)	**For the Years Ended December 31, 2016**	**2015**
Data processing	$(5)	$1,137
Professional services	58	582
Personnel severance	(20)	210
Other	140	42
	$173	$1,971

NOTE 3 — CASH AND DUE FROM BANKS

Cash and due from banks includes balances with the Federal Reserve Bank and other correspondent banks. The Company is required to maintain specified reserves by the Federal Reserve Bank. The average reserve requirements are based on a percentage of the Company's deposit liabilities. In addition, the Federal Reserve Bank requires the Company to maintain a certain minimum balance at all times. As of December 31, 2016 and 2015, the Company had a balance of $65,467,000 and $107,792,000, respectively, which exceeds the reserve requirement.

NOTE 4 — SECURITIES

The amortized cost and estimated fair values of debt securities as of December 31, 2016, are as follows:

(dollars in thousands)	**Amortized Cost**	**Gross Unrealized**	**Gross Unrealized**	**Fair Value**

		Gains	Losses	
Available-for-sale securities:				
U.S. agencies	$ 27,879	$ 616	$ (209)	$ 28,286
Collateralized mortgage obligations	4,159	7	(57)	4,109
Municipalities	77,957	1,318	(946)	78,329
SBA pools	7,219	0	(51)	7,168
Corporate debt	21,349	81	(867)	20,563
Asset backed securities	18,888	32	(101)	18,819
Mutual fund	3,264	0	(205)	3,059
	$ 160,715	$ 2,054	$ (2,436)	$ 160,333

The following tables detail the gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2016.

(dollars in thousands)	Less than 12 months		12 months or more		Total	
	Fair	**Unrealized**	**Fair**	**Unrealized**	**Fair**	**Unrealized**
Description of Securities	**Value**	**Loss**	**Value**	**Loss**	**Value**	**Loss**
U.S. agencies	$8,769	$ (208)	$718	$ (1)	$9,487	$ (209)
Collateralized mortgage obligations	3,166	(57)	0	0	3,166	(57)
Municipalities	45,137	(917)	402	(29)	45,539	(946)
SBA pools	6,415	(46)	753	(5)	7,168	(51)
Corporate debt	12,776	(757)	2,884	(110)	15,660	(867)
Asset backed securities	2,576	(15)	8,272	(86)	10,848	(101)
Mutual fund	0	0	3,059	(205)	3,059	(205)
Total temporarily impaired securities	$78,839	$ (2,000)	$16,088	$ (436)	$94,927	$ (2,436)

At December 31, 2016, there was one U.S. agency, one municipality, two SBA pools, four corporate debts, five asset backed securities, and one mutual fund that comprised the total securities in an unrealized loss position for greater than 12 months and seven U.S. agencies, two collateralized mortgage obligations, forty-four municipalities, three SBA pools, eight corporate debts, and one asset backed security that make up the total securities in a loss position for less than 12 months. Management periodically evaluates each available-for-sale investment security in an unrealized loss position to determine if the impairment is temporary or other than temporary. This evaluation encompasses various factors including, the nature of the investment, the cause of the impairment, the severity and duration of the impairment, credit ratings and other credit related factors such as third party guarantees and volatility of the security’s fair value. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due primarily to interest rate changes and the Company does not intend to sell the securities and it is not likely that we will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security.

The amortized cost and estimated fair value of debt securities at December 31, 2016, by contractual maturity or call date, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(dollars in thousands)	**Amortized Cost**	**Fair Value**
Available-for-sale securities:		
Due in one year or less	$ 9,880	$10,433

Due after one year through five years	52,380	52,005
Due after five years through ten years	65,103	64,789
Due after ten years	33,352	33,106
	$ 160,715	$ 160,333

The amortized cost and estimated fair values of debt securities as of December 31, 2015, are as follows:

(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. agencies	$ 31,815	$ 1,142	$ (89)	$ 32,868
Collateralized mortgage obligations	2,729	17	(27)	2,719
Municipalities	66,535	2,248	(197)	68,586
SBA pools	811	0	(5)	806
Corporate debt	13,497	44	(121)	13,420
Asset backed securities	10,321	0	(183)	10,138
Mutual fund	3,172	0	(163)	3,009
	$ 128,880	$ 3,451	$ (785)	$ 131,546

The following tables detail the gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2015.

(dollars in thousands)	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. agencies	$ 7,129	$ (30)	$ 1,800	$ (59)	$ 8,929	$ (89)
Collateralized mortgage obligations	0	0	1,266	(27)	1,266	(27)
Municipalities	11,451	(123)	3,680	(74)	15,131	(197)
SBA pools	0	0	807	(5)	807	(5)
Corporate debt	9,376	(121)	0	0	9,376	(121)
Asset backed securities	5,351	(78)	4,787	(105)	10,138	(183)
Mutual fund	0	0	3,009	(163)	3,009	(163)
Total temporarily impaired securities	$ 33,307	$ (352)	$ 15,349	$ (433)	$ 48,656	$ (785)

The Company recognized gross realized gains of $52,000 and $238,000 during 2016 and 2015, respectively, on certain available-for-sale securities that were called or sold. The gains in 2015 reflected in the condensed consolidated statements of income are net of a $32,000 gross realized loss related to one available-for-sale security sold during the first quarter of 2015, compared to no sales of securities and no losses on called securities during 2016. There were no losses on called available-for-sale securities realized during 2016 and 2015.

Securities carried at $89,362,000 and $65,902,000 at December 31, 2016 and 2015, respectively, were pledged to secure deposits of public funds.

NOTE 5 — LOANS

The Company's customers are primarily located in Stanislaus, San Joaquin, Tuolumne, Inyo, and Mono Counties. As of December 31, 2015, approximately 78% of the Company's loans are commercial real estate loans which includes construction loans. Approximately 11% of the Company's loans are for general commercial uses including professional, retail, and small business. Additionally, 6% of the Company's loans are for residential real estate and other consumer loans. The remaining 5% are agriculture loans.

Loan totals were as follows:

(in thousands)	YEAR ENDED DECEMBER 31, 2016	2015
Commercial real estate:		
Commercial real estate- construction	$23,378	$19,363
Commercial real estate- mortgages	389,495	363,644
Land	9,823	10,239
Farmland	56,159	29,801
Commercial and industrial	64,201	63,776
Consumer	767	774
Consumer residential	38,672	32,588
Agriculture	28,454	20,847
Total loans	610,949	541,032
Less:		
Deferred loan fees and costs, net	(2,013)	(3,282)
Allowance for loan losses	(7,832)	(7,356)
Net loans	$601,104	$530,394

Loan Origination/Risk Management. The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. Once it is determined that the borrower's management possesses sound ethics and solid business acumen, the Company's management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Company avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Company also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans. At December 31, 2016, approximately 40.9% of the outstanding principal balance of the Company's commercial real estate loans were secured by owner-occupied properties.

With respect to loans to developers and builders that are secured by non-owner occupied properties that the Company may originate from time to time, the Company generally requires the borrower to have had an existing relationship with the Company and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

The Company originates consumer loans utilizing a computer-based credit scoring analysis to supplement the underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by line and staff personnel. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans follow bank policy, which include, but are not limited to, a maximum loan-to-value percentage of 80%, a maximum housing and total debt ratio of 36% and 42%, respectively and other specified credit and documentation requirements.

The Company maintains an independent loan review department that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

Purchased Credit-Impaired ("PCI") Loans. We evaluated loans purchased in the Acquisition in accordance with accounting guidance in ASC 310-30 related to loans acquired with deteriorated credit quality. Acquired loans are considered credit-impaired if there is evidence of significant deterioration of credit quality since origination and it is probable, at the acquisition date, that we will be unable to collect all contractually required payments receivable. Management has determined certain loans purchased in the MLB Acquisition to be PCI loans based on credit indicators such as nonaccrual status, past due status, loan risk grade, loan-to-value ratio, etc. Revolving credit agreements (e.g., home equity lines of credit and revolving commercial loans) are not considered PCI loans as cash flows cannot be reasonably estimated.

For acquired loans not considered credit-impaired, the difference between the contractual amounts due (principal amount) and the fair value is accounted for subsequently through accretion. We recognize discount accretion based on the acquired loan's contractual cash flows using an effective interest rate method. The accretion is recognized through the net interest margin.

The following table presents the fair value of purchased credit-impaired and other loans acquired from Mother Lode Bank as of the acquisition date:

	December 23, 2015		
(in thousands)	Purchased credit-impaired loans	Other purchased loans	Total
Contractually required payments including interest	$ 1,982	$ 44,007	$ 45,989
Less: nonaccretable difference	(1,103)	0	(1,103)
Cash flows expected to be collected (undiscounted)	879	44,007	44,886
Accretable yield	(14)	(2,041)	(2,055)
Fair value of purchased loans	$ 865	$ 41,966	$ 42,831

The following table reflects the outstanding balance and related carrying value of PCI loans as of December 31, 2016 and December 31, 2015:

(in thousands)	December 31, 2016		December 31, 2015	
	Unpaid principal balance	Carrying value	Unpaid principal balance	Carrying value
Commercial real estate:				
Commercial real estate- construction	$0	$ 0	$0	$ 0
Commercial real estate- mortgages	0	0	196	118
Land	280	33	795	269
Farmland	0	0	0	0
Commercial and industrial	0	0	794	478
Consumer	0	0	0	0
Consumer residential	0	0	0	0
Agriculture	0	0	0	0
Total purchased credit-impaired loans	$280	$ 33	$1,785	$ 865

For the PCI loans, the accretable yield represents the excess of the cash flows expected to be collected at acquisition over the fair value of the loans at the acquisition date, and is accreted into interest income over the estimated remaining life of the purchased credit-impaired loans using the effective yield method, provided that the timing and amount of future cash flows is reasonably estimable. The cash flows expected to be collected are updated each quarter based on current assumptions regarding default rates, loss severities, and other factors that are reflective of current market conditions. Probable decreases in expected cash flows after acquisition result in the recognition of impairment as a specific allowance for loan losses or a charge-off to the allowance. The nonaccretable difference represents the difference between the undiscounted contractual cash flows and the undiscounted expected cash flows, and also reflects the estimated credit losses in the acquired loan portfolio at the acquisition date and can fluctuate due to changes in expected cash flows during the life of the PCI loans. Due to the timing of the Acquisition being near December 31, 2015, the accretable yield at Acquisition approximates the accretable yield at December 31, 2015.

Non-Accrual and Past Due Loans. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Year-end non-accrual loans, segregated by class of loans, were as follows:

(in thousands)	YEAR ENDED DECEMBER 31, 2016	2015
Commercial real estate:		
Commercial real estate- construction	$0	$0
Commercial real estate- mortgages	0	0
Land	2,715	2,739
Farmland	0	51
Commercial and industrial	306	322
Consumer	0	0
Consumer residential	16	0
Agriculture	0	2,704
Total non-accrual loans	$3,037	$5,816

(1) Excluded from the above non-accrual loan table are Purchased Credit Impaired loans acquired in the MLB Acquisition.

Had non-accrual loans performed in accordance with their original contract terms, the Company would have recognized additional interest income of approximately $156,000 in 2016 and $376,000 in 2015.

The following table analyzes past due loans including the non-accrual loans in the above table, segregated by class of loans, as of December 31, 2016 (in thousands):

December 31, 2016	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Purchased Credit Impaired Loans	Total	Greater Than 90 Days Past Due and Still

								Accruing
Commercial real estate:								
Commercial R.E. - construction	$ 0	$ 0	$ 0	$ 0	$ 23,378	$ 0	23,378	$ 0
Commercial R.E. - mortgages	0	0	0	0	389,495	0	389,495	0
Land	0	0	2,715	2,715	7,075	33	9,823	0
Farmland	0	0	0	0	56,159	0	56,159	0
Commercial and industrial	0	0	302	302	63,899	0	64,201	0
Consumer	0	0	0	0	767	0	767	0
Consumer residential	0	0	16	16	38,656	0	38,672	0
Agriculture	0	0	0	0	28,454	0	28,454	0
Total	$ 0	$ 0	$ 3,033	$ 3,033	$ 607,883	$ 33	610,949	$ 0

The following table analyzes past due loans including the non-accrual loans in the above table, segregated by class of loans, as of December 31, 2015 (in thousands):

December 31, 2015	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Purchased Credit Impaired Loans	Total	Greater Than 90 Days Past Due and Still Accruing
Commercial real estate:								
Commercial R.E. - construction	$0	$0	$0	$0	$19,363	$ 0	$19,363	$ 0
Commercial R.E. – mortgages	0	0	0	0	363,526	118	363,644	0
Land	0	0	2,261	2,261	7,709	269	10,239	0
Farmland	1,182	0	51	1,233	28,568	0	29,801	0
Commercial and industrial	352	0	312	664	62,634	478	63,776	0
Consumer	0	0	0	0	774	0	774	0
Consumer residential	0	0	0	0	32,588	0	32,588	0
Agriculture	0	2,704	0	2,704	18,143	0	20,847	0
Total	$1,534	$2,704	$2,624	$6,862	$533,305	$ 865	$541,032	$ 0

Impaired Loans. Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Impaired loans by class as of December 31, 2016 and 2015 are set forth in the following tables. PCI loans are excluded from the tables, as they have not experienced post acquisition declines in cash flows expected to be collected. No interest income was recognized on impaired loans subsequent to their classification as impaired during 2016 and 2015.

(in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
December 31, 2016						
Commercial real estate:						
Commercial R.E. - construction	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Commercial R.E. - mortgages	0	0	0	0	0	0
Land	3,131	2,715	0	2,715	680	2,476
Farmland	0	0	0	0	0	0
Commercial and Industrial	353	4	302	306	0	313
Consumer	0	0	0	0	0	0
Consumer residential	16	16	0	16	0	0
Agriculture	0	0	0	0	0	0
Total	$ 3,500	$ 2,735	$ 302	$ 3,037	$ 680	$ 2,789

(in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
<u>December 31, 2015</u>						
Commercial real estate:						
Commercial R.E. - construction	$ 0	$ 0	$ 0	$ 0	$ 0	0
Commercial R.E. - mortgages	0	0	0	0	0	301
Land	3,856	0	2,739	2,739	722	2,914
Farmland	63	51	0	51	0	61
Commercial and Industrial	357	322	0	322	0	611
Consumer	0	0	0	0	0	0
Consumer residential	0	0	0	0	0	0
Agriculture	2,704	2,704	0	2,704	0	7
Total	$ 6,980	$ 3,077	$ 2,739	$ 5,816	$ 722	3,894

Troubled Debt Restructurings – In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company’s internal underwriting policy.

At December 31, 2016, there were 6 loans that were considered to be troubled debt restructurings, all of which are considered non-accrual totaling $3,037,000. At December 31, 2015, there were 5 loans that were considered to be troubled debt restructurings, all of which are considered non-accrual totaling $3,060,000. There were no unfunded commitments on TDR loans at December 31, 2016 and 2015. We have allocated $680,000 and $722,000 of specific reserves to loans whose terms have been modified in troubled debt restructurings as of December 31, 2016 and 2015, respectively.

During the year ended December 31, 2016, the terms of two loans were modified as troubled debt restructurings, as compared to two loans during 2015. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date; or a temporary payment modification in which the payment amount allocated towards principal was reduced. In some cases, a permanent reduction of the accrued interest on the loan was conceded.

During 2016 and 2015, two loans were modified as troubled debt restructurings totaling $308,000 and $594,000, respectively. The troubled debt restructurings during the years ended December 31, 2016 and 2015 did not modify the principal balances, did not increase the allowance for loan losses and there were no charge offs as a result of the loan modifications.

There was one commercial real estate loan with a balance of $289,000 that was modified as troubled debt restructuring and had a subsequent payment default during the year ended December 31, 2016, as compared to no payment defaults of modified loans during 2015.

A loan is considered to be in payment default once it is thirty days contractually past due under the modified terms.

Quality ratings (Risk Grades) are assigned to all commitments and stand-alone notes. Risk grades define the basic characteristics of commitments or stand-alone note in relation to their risk. All loans are graded using a system that maximizes the loan quality information contained in loan review grades, while ensuring that the system is compatible with the grades used by bank examiners.

We grade loans using the following letter system:

1 Exceptional Loan

2 Quality Loan

3A Better Than Acceptable Loan

3B Acceptable Loan

3C Marginally Acceptable Loan

4 (W) Watch Acceptable Loan

5 Other Loans Especially Mentioned

6 Substandard Loan

7 Doubtful Loan

8 Loss

_1._ _Exceptional Loan_ - Loans with A+ credits that contain very little, if any, risk. Grade 1 loans are considered Pass. To qualify for this rating, the following characteristics must be present:

-A high level of liquidity and whose debt-servicing capacity exceeds expected obligations by a substantial margin.

-Where leverage is below average for the industry and earnings are consistent or growing without severe vulnerability to economic cycles.

-Also included in this rating (but not mandatory unless one or more of the preceding characteristics are missing) are loans that are fully secured and properly margined by our own time instruments or U.S. blue chip securities. To be properly margined cash collateral must be equal to, or greater than, 110% of the loan amount.

_2._ _Quality Loan_ - Loans with excellent sources of repayment that conform in all respects to bank policy and regulatory requirements. These are also loans for which little repayment risk has been identified. No credit or collateral exceptions. Grade 2 loans are considered Pass. Other factors include:

-Unquestionable debt-servicing capacity to cover all obligations in the ordinary course of business from well-defined primary and secondary sources.

-Consistent strong earnings.

-A solid equity base.

_3A._ _Better than Acceptable Loan_ - In the interest of better delineating the loan portfolio’s true credit risk for reserve allocation, further granularity has been sought by splitting the grade 3 category into three classifications. The distinction between the three are bank-defined guidelines and represent a further refinement of the regulatory definition of a pass, or grade 3 loan. Grade 3A is the stronger third of the pass category, but is not strong enough to be a grade 2 and is characterized by:

-Strong earnings with no loss in last three years and ample cash flow to service all debt well above policy guidelines.

-Long term experienced management with depth and defined management succession.

-The loan has no exceptions to policy.

-Loan-to-value on real estate secured transactions is 10% to 20% less than policy guidelines.

-Very liquid balance sheet that may have cash available to pay off our loan completely.

-Little to no debt on balance sheet.

3B. *Acceptable Loan* - 3B loans are simply defined as all loans that are less qualified than 3A loans and are stronger than 3C loans. These loans are characterized by acceptable sources of repayment that conform to bank policy and regulatory requirements. Repayment risks are acceptable for these loans. Credit or collateral exceptions are minimal, are in the process of correction, and do not represent repayment risk. These loans:

-Are those where the borrower has average financial strengths, a history of profitable operations and experienced management.

-Are those where the borrower can be expected to handle normal credit needs in a satisfactory manner.

3C. *Marginally Acceptable* - 3C loans have similar characteristics as that of 3Bs with the following additional characteristics:

Requires collateral. A credit facility where the borrower has average financial strengths, but usually lacks reliable secondary sources of repayment other than the subject collateral. Other common characteristics can include some or all of the following: minimal background experience of management, lacking continuity of management, a start-up operation, erratic historical profitability (acceptable reasons-well identified), lack of or marginal sponsorship of guarantor, and government guaranteed loans.

4W *Watch Acceptable* - Watch grade will be assigned to any credit that is adequately secured and performing but monitored for a number of indicators. These characteristics may include any unexpected short-term adverse financial performance from budgeted projections or prior period's results (i.e., declining profits, sales, margins, cash flow, or increased reliance on leverage, including adverse balance sheet ratios, trade debt issues, etc.). Additionally, any managerial or personal problems of company management, decline in the entire industry or local economic conditions failure to provide financial information or other documentation as requested; issues regarding delinquency, overdrafts, or renewals; and any other issues that cause concern for the company. Loans to individuals or loans supported by guarantors with marginal net worth and/or marginal collateral. Weakness identified

in a Watch credit is short-term in nature. Loans in this category are usually accounts the Company would want to retain providing a positive turnaround can be expected within a reasonable time frame. Grade 4 loans are considered Pass.

5 *Other Loans Especially Mentioned (Special Mention)* - A special mention extension of credit is defined as having potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may, at some future date result in the deterioration of the repayment prospects for the credit or the institution's credit position. Extensions of credit that might be detailed in this category include the following:

-The lending officer may be unable to properly supervise the credit because of an inadequate loan or credit agreement.

-Questions exist regarding the condition of and/or control over collateral.

-Economic or market conditions may unfavorably affect the obligor in the future.

-A declining trend in the obligor's operations or an imbalanced position in the balance sheet exists, but not to the point that repayment is jeopardized.

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6 Substandard Loan - A "substandard" extension of credit is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Extensions of credit so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard credits, does not have to exist in individual extensions of credit classified substandard.

7 Doubtful Loan - An extension of credit classified "doubtful" has all the weaknesses inherent in one classified substandard, 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 that may work to the advantage of and strengthen the credit, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors may include a proposed merger or acquisition, liquidation proceedings, capital injection, perfecting liens on additional collateral or refinancing plans. The entire loan need not be classified doubtful when collection of a specific portion appears highly probable. An example of proper use of the doubtful category is the case of a company being liquidated, with the trustee-in-bankruptcy indicating a minimum disbursement of 40 percent and a maximum of 65 percent to unsecured creditors, including the Company. In this situation, estimates are based on liquidation value appraisals with actual values yet to be realized. By definition, the only portion of the credit that is doubtful is the 25 percent difference between 40 and 65 percent. A proper classification of such a credit would show 40 percent substandard, 25 percent doubtful, and 35 percent loss. A credit classified as doubtful should be resolved within a 'reasonable' period of time. Reasonable is generally defined as the period between examinations. In other words, a credit classified doubtful at an examination should be cleared up before the next exam. However, there may be situations that warrant continuation of the doubtful classification a while longer.

8. Loss - Extensions of credit classified "loss" are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the credit has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off, even though partial recovery may be affected in the future. It should not be the Company's practice to attempt long-term recoveries while the credit remains on the books. Losses should be taken in the period in which they surface as uncollectible.

As of December 31, 2016 and 2015, there are no loans that are classified with a risk grade of *8- Loss.*

The following table presents weighted average risk grades of our loan portfolio.

	December 31, 2016	December 31, 2015

	Weighted Average Risk Grade	Weighted Average Risk Grade
Commercial real estate:		
Commercial real estate - construction	3.07	3.72
Commercial real estate - mortgages	3.08	3.16
Land	4.39	4.58
Farmland	3.09	3.12
Commercial and industrial	2.70	3.57
Consumer	2.28	1.99
Consumer residential	3.03	3.01
Agriculture	3.08	3.39
Total gross loans	3.06	3.25

The following table presents risk grade totals by class of loans as of December 31, 2016 and 2015. Risk grades 1 through 4 have been aggregated in the "Pass" line.

(in thousands)	Commercial R.E. Construction	Commercial R.E. Mortgages (1)	Land (1)	Farmland	Commercial and Industrial (1)	Consumer	Consumer Residential	Agriculture	Total
December 31, 2016									
Pass	$ 22,560	$ 388,365	$ 6,637	$ 56,159	$ 62,770	$ 738	$ 38,300	$ 28,454	$ 603,983
Special mention	818	1,063	-	-	189	-	-	-	2,070
Substandard	-	67	2,906		1,242	29	372	-	4,616
Doubtful	-	-	280	-	-	-	-	-	280
Total loans	$ 23,378	$ 389,495	$ 9,823	$ 56,159	$ 64,201	$ 767	$ 38,672	$ 28,454	$ 610,949
December 31, 2015									
Pass	$ 18,312	$ 357,339	$ 6,358	$ 28,568	$ 55,957	$ 745	$ 32,532	$ 18,143	$ 517,954
Special mention	-	4,389	110	-	6,153	-	-	-	10,652
Substandard	1,051	1,916	3,283	1,233	1,416	29	56	2,704	11,688
Doubtful	-	-	488	-	250	-	-	-	738
Total loans	$ 19,363	$ 363,644	$ 10,239	$ 29,801	$ 63,776	$ 774	$ 32,588	$ 20,847	$ 541,032

(1) Included in the above table is Purchased Credit Impaired loans recorded at their fair value of $33,000 and $865,000 as of December 31, 2016 and 2015, respectively, which were acquired in the MLB Acquisition.

Allowance for Loan Losses. The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Company's allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, "Receivables" and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Company's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision for loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including, among other things, the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Company's allowance for loan losses consists of three elements: (i) specific valuation allowances determined in accordance with ASC Topic 310 based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC Topic 450 based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted, as necessary, to reflect the impact of current conditions; and (iii) general valuation allowances determined in accordance with ASC Topic 450 based on general economic conditions and other qualitative risk factors both internal and external to the Company.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship manager level for all commercial loans. When a loan has a calculated grade of 5 or higher, a special assets officer analyzes the loan to determine whether the loan is impaired and, if impaired, the need to specifically allocate a portion of the allowance for loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower's ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower's industry, among other things.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans and the internal risk grade of such loans at the time they were charged-off. The Company calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool. The Company's pools of similar loans include similarly risk-graded groups of commercial and industrial loans, commercial real estate loans, consumer real estate loans and consumer and other loans.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the Company's lending management and staff; (ii) the effectiveness of the Company's loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the impact of competition on loan structuring and pricing; (vii) the effectiveness of the internal loan review function; (viii) the impact of environmental risks on portfolio risks; and (ix) the impact of rising interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. Each component is determined to have either a high, moderate or low degree of risk. The results are then input into a "general allocation matrix" to determine an appropriate general valuation allowance.

Included in the general valuation allowances are allocations for groups of similar loans with risk characteristics that exceed certain concentration limits established by management. Concentration risk limits have been established, among other things, for certain industry concentrations, large balance and highly leveraged credit relationships that exceed specified risk grades, and loans originated with policy exceptions that exceed specified risk grades.

Loans identified as losses by management, internal loan review and/or bank examiners are charged-off. Furthermore, consumer loan accounts are charged-off automatically based on regulatory requirements.

The following table details activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2016 and 2015. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

Allowance for Loan Losses For the Year Ended December 31, 2016 and 2015

(in thousands)	Commercial	Commercial	Consumer	Consumer	Agriculture	Unallocated	Total
Year Ended December 31, 2016	Real Estate	and Industrial		Residential			
Beginning balance	$ 5,920	$ 627	$ 38	$ 426	$ 309	$ 36	$ 7,356
Charge-offs	0	0	(18)	0	0	0	(18)
Recoveries	4	0	5	1	0	0	10
(Reversal of) provision for loan losses	261	70	26	(102)	195	34	484
Ending balance	$ 6,185	$ 697	$ 51	$ 325	$ 504	$ 70	$ 7,832
Year Ended December 31, 2015							
Beginning balance	$ 5,963	$ 720	$ 42	$ 388	$ 286	$ 135	$ 7,534
Charge-offs	0	(32)	(30)	0	0	0	(62)
Recoveries	5	0	4	0	0	0	9
(Reversal of) provision for loan losses	(48)	(61)	22	38	23	-99	(125)
Ending balance	$ 5,920	$ 627	$ 38	$ 426	$ 309	$ 36	$ 7,356

The following table details the allowance for loan losses and ending gross loan balances as of December 31, 2016 and 2015, summarized by collective and individual evaluation methods of impairment.

(in thousands)

December 31, 2016	Commercial Real Estate	Commercial and Industrial	Consumer	Consumer Residential	Agriculture	Unallocated	Total
Allowance for loan losses for loans:							
Individually evaluated for impairment	$ 680	$ 0	$ 0	$ 0	$ 0		$ 680
Collectively evaluated for impairment	5,505	697	51	325	504	70	7,152
	$ 6,185	$ 697	$ 51	$ 325	$ 504	$ 70	$ 7,832
Ending gross loan balances:							
Individually evaluated for impairment	$ 2,715	$ 306	$ 0	$ 16	$ 0	$ 0	$ 3,037
Individually evaluated purchased credit impaired loans	33	0	0	0	0	0	33
Collectively evaluated for impairment	476,107	63,895	767	38,656	28,454	0	607,879
	$ 478,855	$ 64,201	$ 767	$ 38,672	$ 28,454	$ 0	$ 610,949
December 31, 2015							
Allowance for loan losses for loans:							
Individually evaluated for impairment	$ 722	$ 0	$ 0	$ 0	$ 0		$ 722
Collectively evaluated for impairment	5,198	627	38	426	309	36	6,634
	$ 5,920	$ 627	$ 38	$ 426	$ 309	$ 36	$ 7,356
Ending gross loans balances:							
Individually evaluated for impairment	$ 2,790	$ 322	$ 0	$ 0	$ 2,704	$ 0	$ 5,816
Individually evaluated purchased credit impaired loans	387	478	0	0	0	0	865
Collectively evaluated for impairment	419,870	62,976	774	32,588	18,143	0	534,351
	$ 423,047	$ 63,776	$ 774	$ 32,588	$ 20,847	$ 0	$ 541,032

Changes in the allowance off-balance-sheet commitments were as follows:

(in thousands)	YEARS ENDED DECEMBER 31, 2016	2015
Balance, beginning of year	$ 238	$ 218
Provision charged to operations for off balance sheet	46	7
Acquired balance from Mother Lode Bank (fair value)	0	13
Balance, end of year	$ 284	$ 238

The method for calculating the reserve for off-balance-sheet loan commitments is based on a reserve percentage which is less than other outstanding loan types because they are at a lower risk level. This reserve percentage, based on many factors including historical losses and existing economic conditions, is evaluated by management periodically and is applied to the total undisbursed loan commitment balance to calculate the reserve for off-balance-sheet commitments. Reserves for off-balance-sheet commitments are recorded in interest payable and other liabilities on the consolidated balance sheets.

At December 31, 2016 and 2015, loans carried at $610,949,000 and $541,032,000, respectively, were pledged as collateral on advances from the Federal Home Loan Bank.

NOTE 6 — PREMISES AND EQUIPMENT

Major classifications of premises and equipment are summarized as follows:

(in thousands)	DECEMBER 31,	
	2016	**2015**
Land	$4,755	$4,755
Building	9,064	8,939
Leasehold improvements	4,307	4,135
Furniture, fixtures, and equipment	7,470	7,132
	25,596	24,961
Less accumulated depreciation	(11,908)	(10,684)
	$13,688	$14,277

Depreciation expense was $1,252,000 and $1,207,000 and for the years ended December 31, 2016 and 2015, respectively.

NOTE 7 — INTEREST RECEIVABLE AND OTHER ASSETS

Other assets are summarized as follows:

(in thousands)	DECEMBER 31,	
	2016	**2015**
Cash surrender value of life insurance	$18,004	$13,747
Net deferred tax asset	4,729	2,788
Goodwill	3,313	3,313
Federal Home Loan Bank stock	3,037	2,958
Interest income receivable on loans	1,688	1,495
Interest income receivable on investments	1,143	925
Core deposit intangible	872	1,031
Federal Reserve Bank stock	758	758
Investment in limited partnership	328	388

Prepaid expenses and other	1,093	749
	$34,965	$28,152

NOTE 8 — DEPOSITS

Deposit totals were as follows:

(in thousands)	DECEMBER 31, 2016	2015
Demand	$336,083	$279,367
NOW accounts	164,847	130,674
Money market deposit accounts	283,643	282,449
Savings	75,122	71,627
Time, $250,000 and under	33,428	35,482
Time, over $250,000	20,970	15,092
Total deposits	$914,093	$814,691

Certificates of deposit issued and their remaining maturities at December 31, 2016, are as follows (in thousands):

Year ending December 31,	
2017	$39,953
2018	4,958
2019	9,355
2020	109
2021	23
	$54,398

NOTE 9 — FHLB ADVANCES

At December 31, 2016, the Company had no outstanding advances from the Federal Home Loan Bank (“FHLB”). Unused and available advances totaled $236,730,000 at December 31, 2016. Loans carried at $610,949,000 as of December 31, 2016, were pledged as collateral on advances from the Federal Home Loan Bank.

At December 31, 2015, the Company had no outstanding advances from the Federal Home Loan Bank ("FHLB"). Unused and available advances totaled $198,415,000 at December 31, 2015. Loans carried at $541,032,000 as of December 31, 2015, were pledged as collateral on advances from the Federal Home Loan Bank.

NOTE 10 — INTEREST ON DEPOSITS

Interest on deposits was comprised of the following:

	YEARS ENDED DECEMBER 31,	
(in thousands)	**2016**	**2015**
Savings and other deposits	$ 594	$ 423
Time deposits over $250,000	63	26
Other time deposits	107	166
	$ 764	$ 615

NOTE 11 — INCOME TAXES

The provision for income taxes consists of the following:

(in thousands)	YEARS ENDED DECEMBER 31, 2016	2015
Current		
Federal	$3,117	$1,498
State	1,044	521
	4,161	2,019
Deferred		
Federal	(568)	64
State	(119)	(29)
	(687)	35
	$3,474	$2,054

The components of the Company's deferred tax assets and liabilities (included in accrued interest and other assets on the consolidated balance sheets, is shown below:

(in thousands)	DECEMBER 31, 2016	2015
Deferred tax assets:		
Allowance for loan losses	$3,222	$3,026
Restricted stock expense	49	50
Accrued vacation	88	72
Accrued salary continuation liability	1,137	1,004
Deferred compensation	108	110
Nonaccrual loans	218	213
Reserve for undisbursed commitments	111	92
OREO expenses	241	274
State income tax	409	244
Holding company organization fees	25	30
Unrealized loss on securities available for sale	157	0
	5,765	5,115
Deferred tax liabilities:		
Prepaid expenses	(107)	(120)
FHLB dividends	(220)	(220)
Accumulated depreciation	(396)	(554)
Deferred loan costs	(419)	(334)
Accrued bonus	14	(2)
Core deposit intangible	37	0
Goodwill tax amortization	(98)	0
Merger costs	153	0
Unrealized gain on securities available for sale	0	(1,097)
	(1,036)	(2,327)
Net deferred income tax asset	$4,729	$2,788

During the third quarter of 2016, the Company determined that deferred tax assets acquired from MLB totaling $2,651,000, mainly from net operating loss carryforwards, cannot be utilized by the Company. As a result, the Company decreased deferred tax assets and increased goodwill by $2,651,000 as of the December 23, 2015 acquisition date which is reflected in the December 31, 2015 figures in the table above. See Note 2 for further discussion of the goodwill and deferred tax asset adjustment.

Management has assessed the realizability of deferred tax assets and believes it is more likely than not that all deferred tax assets will be realized in the normal course of operations. Accordingly, these assets have not been reduced by a valuation allowance.

The Company periodically reviews its income tax positions based on tax laws and regulations and financial reporting considerations, and records adjustments as appropriate. This review takes into consideration the status of current taxing authorities' examinations of the Company's tax returns, recent positions taken by the taxing authorities on similar transactions, if any, and the overall tax environment.

The Company had no liabilities for unrecognized tax benefits as of December 31, 2016. During 2015, the Company settled the exams for the tax years of 2010, 2011, 2012 and 2013 with the California Franchise Tax Board ("FTB") by submitting a payment of $332,000. The net impact of this payment after the federal deduction was $219,000 and therefore resulted in a reversal of $83,000 to tax expense to clear the unrecognized tax benefit liability account of $302,000 as described below. The Company had no liabilities for unrecognized tax benefits as of December 31, 2016 and 2015.

The effective tax rate for 2016 and 2015 differs from the current Federal statutory income tax rate as follows:

	YEARS ENDED DECEMBER 31,	
	2016	**2015**
Federal statutory income tax rate	34.0 %	34.0 %
State taxes, net of federal tax benefit	7.2 %	7.2 %
Tax exempt interest on municipal securities and loans	-6.2 %	-8.7 %
Tax exempt earnings on bank owned life insurance	-1.6 %	-2.5 %
Reversal of reserve for tax exams	0.0 %	-1.2 %
Low income housing tax credit	-0.6 %	-0.9 %
California enterprise zone tax credits and deductions	-0.1 %	-0.5 %
(Adjustment of) non-deductible merger expenses	-1.5 %	2.4 %
Other	0.0 %	-0.2 %
Effective tax rate	31.2 %	29.5 %

Oak Valley Bancorp files a consolidated return in the U.S. Federal tax jurisdiction and a combined report in the State of California tax jurisdiction. None of the entities are subject to examination by taxing authorities for years before 2013 for U.S. Federal or for years before 2012 for California.

NOTE 12 — STOCK OPTION PLAN

The Company currently has two equity based incentive plans, the Oak Valley Community Bank 1998 Restated Stock Option Plan and the Oak Valley Bancorp 2008 Stock Plan. The 2008 Stock Plan provides for awards in the form of incentive stocks, non-statutory stock options, stock appreciation rights and restrictive stocks. Under the 2008 Plan, the Company is authorized to issue 1,500,000 shares of its common stock to key employees and directors as incentive and non-qualified stock options, respectively, at a price equal to the fair value on the date of grant. The Plan provides that the options are exercisable in equal increments over a five-year period from the date of grant or over any other schedule approved by the Board of Directors. All incentive stock options expire no later than ten years from the date of grant. Future grants are not permitted under the 1998 Stock Plan and will all be issued from the 2008 Stock Plan.

A summary of the status of the Company's stock option plan and changes during the year are presented below.

	DECEMBER 31, 2016	
	Shares	**Weighted-Average Exercise Price**
Outstanding at beginning of year	33,000	$ 12.13
Granted	0	$ 0.00
Exercised	0	$ 0.00
Forfeited	(18,000)	$ 14.26
Outstanding at end of year	15,000	$ 9.58

(dollars in thousands)	**December 31,**	
	2016	**2015**
Weighted-average fair value of options granted during the year	N/A	N/A
Intrinsic value of options exercised	N/A	N/A
Options outstanding and exercisable at year end:	15,000	33,000
Weighted average exercise price	$9.58	$12.13
Intrinsic value	$45	$19
Weighted average remaining contractual life (years)	0.84	1.13

There were no tax benefits recorded in the consolidated statements of income during 2016 and 2015 related to the vesting of non-qualified stock options. For the years ended December 31, 2016 and 2015, there were no exercises of stock options and therefore no income tax benefits related to disqualifying dispositions. All outstanding stock options became fully vested during 2014 and therefore there was no recognition of stock option compensation expense in the consolidated statements of income in 2015 or 2016.

A summary of the status of the Company's restricted stock and changes during the year are presented below.

	DECEMBER 31, 2016	
	Shares	**Weighted-Average Grant Date Fair Value**
Unvested at beginning of year	81,511	$ 7.59
Granted	17,000	$ 9.61
Vested	(35,736)	$ 7.24
Cancelled	(6,700)	$ 9.80
Unvested at end of year	56,075	$ 8.16

The Company granted 17,000 shares of restricted stock in 2016 with a weighted average fair value of $9.61 per share. For the year ended December 31, 2016, total compensation expense recorded in the consolidated statements of income related to restricted stock awards was $256,000, with an offsetting tax benefit of $105,000, as this expense is deductible for income tax purposes. The Company recorded an additional tax benefit of $33,000 to income tax expense to recognize the full tax deduction of the vested restricted stock, which is equal to the fair value on the vesting date, as the tax benefit from the restricted stock expense is based on the grant date fair value. As of December 31, 2016, there was $260,000 of total unrecognized compensation cost related to restricted stock awards which is expected to be recognized over a weighted-average period of 2.89 years. During 2016, shares of restricted stock awards totaling 35,736 with a fair value of $321,000, based on the vested date of each award, were vested and became unrestricted.

NOTE 13 — EARNINGS PER SHARE

Earnings per share ("EPS") are based upon the weighted average number of common shares outstanding during each year. The following table shows: (1) weighted average basic shares, (2) effect of dilutive securities related to stock options and non-vested restricted stock, and (3) weighted average diluted shares. Basic EPS are calculated by dividing net income by the weighted average number of common shares outstanding during each period, excluding dilutive stock options and unvested restricted stock awards. Diluted EPS are calculated using the weighted average diluted shares. The total dilutive shares included in annual diluted EPS is a year-to-date weighted average of the total dilutive shares included in each quarterly diluted EPS computation under the treasury stock method. We have two forms of outstanding common stock: common stock and unvested restricted stock awards. Holders of restricted stock awards receive non-forfeitable dividends at the same rate as common stockholders and they both share equally in undistributed earnings. Therefore, under the two class method the difference in EPS is not significant for these participating securities.

The Company's calculation of earnings per share ("EPS") including basic EPS, which does not consider the effect of common stock equivalents and diluted EPS, which considers all dilutive common stock equivalents is as follows:

YEAR ENDED DECEMBER 31, 2016

Weighted Avg