SIERRA BANCORP
Form 10-Q
August 07, 2013

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2013

Commission file number: 000-33063

Sierra Bancorp
(Exact name of Registrant as specified in its charter)

California	33-0937517
(State of Incorporation)	(IRS Employer Identification No)

86 North Main Street, Porterville, California 93257
(Address of principal executive offices) (Zip Code)

(559) 782-4900
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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 R 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes R No £

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer £	Accelerated filer R
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 R

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

Common stock, no par value, 14,170,119 shares outstanding as of July 31, 2013

FORM 10-Q

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PART I - FINANCIAL INFORMATION
Item 1 - Financial Statements
SIERRA BANCORP
CONSOLIDATED BALANCE SHEETS
(dollars in thousands)

	June 30, 2013 (unaudited)	December 31, 2012 (audited)
ASSETS		
Cash and due from banks	$ 41,863	$ 42,079
Interest-bearing deposits in banks	25,119	19,739
Total Cash & Cash Equivalents	66,982	61,818
Investment securities available for sale	393,576	380,188
Loans held for sale	523	210
Loans and leases:		
Gross loans and leases	810,194	879,795
Allowance for loan and lease losses	(12,180)	(13,873)
Deferred loan and lease fees, net	1,237	1,156
Net Loans and Leases	799,251	867,078
Premises and equipment, net	20,932	21,830
Operating leases, net	-	12
Foreclosed assets	10,834	19,754
Goodwill	5,544	5,544
Other assets	80,782	81,469
TOTAL ASSETS	$ 1,378,424	$ 1,437,903
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Non-interest bearing	$ 357,540	$ 352,597
Interest bearing	797,476	821,437
Total Deposits	1,155,016	1,174,034
Federal funds purchased and repurchase agreements	1,963	1,419
Short-term borrowings	-	36,650
Long-term borrowings	-	5,000
Junior subordinated debentures	30,928	30,928
Other liabilities	15,346	15,980
TOTAL LIABILITIES	1,203,253	1,264,011
SHAREHOLDERS' EQUITY		
Common stock, no par value; 24,000,000 shares authorized; 14,144,439 and 14,106,959 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively	64,855	64,384
Additional paid in capital	2,707	2,660
Retained earnings	107,566	103,128
Accumulated other comprehensive income	43	3,720
TOTAL SHAREHOLDERS' EQUITY	175,171	173,892
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 1,378,424	$ 1,437,903

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

SIERRA BANCORP
CONSOLIDATED STATEMENTS OF INCOME
(dollars in thousands, except per share data, unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Interest income:				
Interest and fees on loans	$ 11,368	$ 11,154	$ 22,275	$ 22,297
Interest on investment securities:				
Taxable	1,034	1,751	2,196	3,635
Tax-exempt	672	685	1,291	1,352
Interest on federal funds sold and interest-bearing deposits	16	22	44	37
Total interest income	13,090	13,612	25,806	27,321
Interest expense:				
Interest on deposits	628	809	1,288	1,694
Interest on short-term borrowings	8	13	12	18
Interest on long-term borrowings	-	49	33	180
Interest on mandatorily redeemable trust preferred securities	179	193	356	393
Total interest expense	815	1,064	1,689	2,285
Net Interest Income	12,275	12,548	24,117	25,036
Provision for loan losses	450	3,160	2,050	5,910
Net Interest Income after Provision for Loan Losses	11,825	9,388	22,067	19,126
Non-interest income:				
Service charges on deposit accounts	2,215	2,417	4,288	4,704
Gains on investment securities available-for-sale	-	1	6	71
Other income, net	1,807	1,704	3,844	3,448
Total non-interest income	4,022	4,122	8,138	8,223
Non-interest expense:				
Salaries and employee benefits	5,403	4,911	11,323	10,576
Occupancy expense	1,596	1,563	3,147	3,052
Other	3,718	4,009	8,068	8,894
Total non-interest expenses	10,717	10,483	22,538	22,522
Income before income taxes	5,130	3,027	7,667	4,827
Provision for income taxes	1,331	454	1,535	375
Net Income	$ 3,799	$ 2,573	$ 6,132	$ 4,452

PER SHARE DATA								
Book value	$	12.38	$	12.23	$	12.38	$	12.23
Cash dividends	$	0.06	$	0.06	$	0.12	$	0.12
Earnings per share basic	$	0.27	$	0.18	$	0.43	$	0.32
Earnings per share diluted	$	0.27	$	0.18	$	0.43	$	0.32
Average shares outstanding, basic		14,128,146		14,103,209		14,120,865		14,102,544
Average shares outstanding, diluted		14,227,335		14,107,640		14,211,910		14,107,416
Total shareholder Equity (in thousands)	$	175,171	$	172,537	$	175,171	$	172,537
Shares outstanding		14,144,439		14,103,209		14,144,439		14,103,209
Dividends Paid	$	847,358	$	846,193	$	1,694,024	$	1,692,289

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

SIERRA BANCORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(dollars in thousands, unaudited)

	Three Months Ended June 30,				Six Months Ended June 30,			
	2013		2012		2013		2012	
Net Income	$	3,799	$	2,573	$	6,132	$	4,452
Other comprehensive income, before tax:								
Unrealized gains on securities:								
Unrealized holding (losses) gains arising during period		(6,157)		604		(6,242)		1,709
Less: reclassification adjustment for gains [1]		-		(1)		(6)		(71)
Other comprehensive (loss) income, before tax		(6,157)		603		(6,248)		1,638
Income tax expense related to items of other comprehensive (loss) income, net of tax		2,534		(246)		2,571		(678)
Other comprehensive (loss) income		(3,623)		357		(3,677)		960
Comprehensive income	$	176	$	2,930	$	2,455	$	5,412

[1] Amounts are included in net gains on investment securities available-for-sale on the Consolidated Statements of Income in non-interest revenue. Income tax expense associated with the reclassification adjustment for the quarter ended June 30, 2013 and 2012 was $0 for each period. Income tax expense associated with the reclassification adjustment for the six months ended June 30, 2013 and 2012 was $3 thousand and $29 thousand, respectively.

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

SIERRA BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands, unaudited)

	Six Months Ended June 30, 2013	2012
Cash flows from operating activities:		
Net income	$ 6,132	$ 4,452
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on investment of securities	(6)	(71)
Gain on sales of loans	(68)	(94)
Gain on disposal of fixed assets	(15)	-
Loss on sale on foreclosed assets	269	177
Writedowns on foreclosed assets	188	1,395
Share-based compensation expense	150	122
Provision for loan losses	2,050	5,910
Depreciation and amortization	1,151	1,190
Net amortization on securities premiums and discounts	4,337	4,019
Increase in unearned net loan fees	(81)	(324)
Increase in cash surrender value of life insurance policies	(933)	(861)
Proceeds from sales of loans portfolio	2,288	3,954
Net Increase in loans held-for-sale	(2,533)	(3,007)
Decrease (Increase) in interest receivable and other assets	3,641	(314)
Decrease in other liabilities	(633)	(172)
Net Decrease in FHLB Stock	438	634
Deferred Income Tax Provision	8	88
Excess tax benefit from equity based compensation	(103)	(36)
Net cash provided by operating activities	16,280	17,062
Cash flows from investing activities:		
Maturities of securities available for sale	439	135
Proceeds from sales/calls of securities available for sale	1,221	7,000
Purchases of securities available for sale	(77,966)	(73,752)
Principal pay downs on securities available for sale	52,339	48,591
Net Decrease (Increase) in loans receivable, net	63,776	(80,230)
Purchases of premises and equipment, net	(226)	(2,481)
Proceeds from sales of foreclosed assets	10,546	10,569
Net cash provided by (used in) investing activities	50,129	(90,168)
Cash flows from financing activities:		
(Decrease) Increase in deposits	(19,019)	63,265
Decrease in borrowed funds	(41,650)	(2,480)
Increase (Decrease) in repurchase agreements	544	(147)
Cash dividends paid	(1,694)	(1,692)
Stock options exercised	471	14
Excess tax benefit from equity based compensation	103	36
Net cash (used in) provided by financing activities	(61,245)	58,996

Increase (Decrease) in cash and due from banks	5,164	(14,110)
Cash and Cash Equivalents		
Beginning of period	61,818	63,036
End of period	$ 66,982	$ 48,926

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

Sierra Bancorp

Note 1 The Business of Sierra Bancorp

Sierra Bancorp (the "Company") is a California corporation headquartered in Porterville, California, and is a registered bank holding company under federal banking laws. The Company was formed to serve as the holding company for Bank of the Sierra (the "Bank"), and has been the Bank's sole shareholder since August 2001. The Company exists primarily for the purpose of holding the stock of the Bank and of such other subsidiaries it may acquire or establish. At the present time, the Company's only other subsidiaries are Sierra Statutory Trust II and Sierra Capital Trust III, which were formed in March 2004 and June 2006, respectively, solely to facilitate the issuance of capital trust pass-through securities (TRUPS). Pursuant to the Financial Accounting Standards Board's (FASB's) standard on the consolidation of variable interest entities, these trusts are not reflected on a consolidated basis in the financial statements of the Company. References herein to the "Company" include Sierra Bancorp and its consolidated subsidiary, the Bank, unless the context indicates otherwise.

The Bank is a California state-chartered bank headquartered in Porterville, California, that offers a full range of retail and commercial banking services primarily to communities in the central and southern regions of the San Joaquin Valley. Our branch footprint stretches from Fresno on the north to Bakersfield on the south, and on the southern end extends east through the Tehachapi plateau and into the northwestern tip of the Mojave Desert. The Bank was incorporated in September 1977 and opened for business in January 1978, and in the ensuing years has grown to be the largest independent bank headquartered in the South San Joaquin Valley. Our growth has primarily been organic, but includes the acquisition of Sierra National Bank in 2000. We currently operate 25 full service branch offices throughout our geographic footprint, as well as an internet branch which provides the ability to open deposit accounts online. The Bank's most recent branching activity includes a new branch which opened for business in the city of Selma in February 2011, and the relocation of our Clovis branch to a larger facility in a more convenient location in the third quarter of 2012. In addition to our full-service branches, the Bank has a real estate industries group, an agricultural credit division, an SBA lending unit, and offsite ATM's at six different non-branch locations. The Bank's deposit accounts are insured by the Federal Deposit Insurance Corporation (FDIC) up to maximum insurable amounts.

Note 2 Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in a condensed format, and therefore do not include all of the information and footnotes required by U.S. generally accepted accounting principles (GAAP) for complete financial statements. The information furnished in these interim statements reflects all adjustments that are, in the opinion of management, necessary for a fair statement of the results for such period. Such adjustments are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q. In preparing the accompanying consolidated financial statements, management has taken subsequent events into consideration and recognized them where appropriate. The results of operations in the interim statements are not necessarily indicative of the results that may be expected for any other quarter, or for the full year. Certain amounts reported for 2012 have been reclassified to be consistent with the reporting for 2013. The interim financial information should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2012, as filed with the Securities and Exchange Commission.

Note 3 Current Accounting Developments

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, with the objective of improving the reporting of reclassifications out of accumulated other comprehensive income. ASU 2013-02 requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income, by component. In addition, if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period, an entity is required to present significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional detail about those amounts. For public entities, this update is effective prospectively for reporting periods beginning after December 15, 2012. We adopted ASU 2013-02 effective the first quarter of 2013, thus enhancing our disclosures with regard to items reclassified out of accumulated comprehensive income.

Note 4 Supplemental Disclosure of Cash Flow Information

During the six months ended June 30, 2013 and 2012, cash paid for interest due on interest-bearing liabilities was $1.794 million and $2.117 million, respectively. There was no cash paid for income taxes during the six months ended June 30, 2013 and 2012. Assets totaling $2.622 million and $11.206 million were acquired in settlement of loans for the six months ended June 30, 2013 and June 30, 2012, respectively. We received $10.156 million in cash from the sale of foreclosed assets during the first six months of 2013 relative to $6.886 million during the first six months of 2012, which represents sales proceeds less loans extended to finance such sales totaling $390,000 for the first six months of 2013 and $3.684 million for the first six months of 2012.

Note 5 Share Based Compensation

The 2007 Stock Incentive Plan (the "2007 Plan") was adopted by the Company in 2007. Our 1998 Stock Option Plan (the "1998 Plan") was concurrently terminated, although options to purchase 164,950 shares that were granted prior to the termination of the 1998 Plan were still outstanding as of June 30, 2013 and remain unaffected by the termination. The 2007 Plan provides for the issuance of both "incentive" and "nonqualified" stock options to officers and employees, and of "nonqualified" stock options to non-employee directors of the Company. The 2007 Plan also provides for the potential issuance of restricted stock awards to these same classes of eligible participants, on such terms and conditions as are established at the discretion of the Board of Directors or the Compensation Committee. The total number of shares of the Company's authorized but unissued stock reserved for issuance pursuant to awards under the 2007 Plan was initially 1,500,000 shares, although the number remaining available for grant as of June 30, 2013 was 762,620. The dilutive impact of stock options outstanding is discussed below in Note 6, Earnings per Share. No restricted stock awards have been issued by the Company.

Pursuant to FASB's standards on stock compensation, the value of each option granted is reflected in our income statement as employee compensation or directors' expense, by amortizing the value over the vesting period of such option or by expensing it as of the grant date for immediately vested options. The Company is utilizing the Black-Scholes model to value stock options, and the "multiple option" approach is used to allocate the resulting valuation to actual expense. Under the multiple option approach, an employee's options for each vesting period are separately valued and amortized. This appears to be the preferred method for option grants with multiple vesting periods, which is the case for most options granted by the Company. A pre-tax charge of $57,000 was reflected in the Company's income statement during the second quarter of 2013 and $55,000 was charged during the second quarter of 2012, as expense related to stock options. For the first half, the charges amounted to $151,000 in 2013 and $122,000 in 2012.

Note 6 Earnings per Share

The computation of earnings per share, as presented in the Consolidated Statements of Income, is based on the weighted average number of shares outstanding during each period. There were 14,128,146 weighted average shares outstanding during the second quarter of 2013, and 14,103,209 during the second quarter of 2012. There were 14,120,865 weighted average shares outstanding during the first six months of 2013, and 14,102,544 during the first six months of 2012.

Diluted earnings per share include the effect of the potential issuance of common shares, which for the Company is limited to shares that would be issued on the exercise of "in-the-money" stock options. The dilutive effect of options outstanding was calculated using the treasury stock method, excluding anti-dilutive shares and adjusting for unamortized expense and windfall tax benefits. For the second quarter and first six months of 2013 the dilutive effect of options outstanding calculated under the treasury stock method totaled 99,189 and 91,045, respectively, which were added to basic weighted average shares outstanding for purposes of calculating diluted earnings per share. Likewise, for the second quarter and first six months of 2012 shares totaling 4,431 and 4,872, respectively, were added to basic weighted average shares outstanding in order to calculate diluted earnings per share.

Note 7 Comprehensive Income

Comprehensive income, as presented in the Consolidated Statements of Comprehensive Income, includes net income and other comprehensive income. The Company's only source of other comprehensive income is unrealized gains and losses on available-for-sale investment securities. Gains or losses on investment securities that were realized and included in net income of the current period, which had previously been included in other comprehensive income as unrealized holding gains or losses in the period in which they arose, are considered to be reclassification adjustments that are excluded from other comprehensive income of the current period.

Note 8 Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business, in order to meet the financing needs of its customers. Those financial instruments consist of unused commitments to extend credit and standby letters of credit. They involve, to varying degrees, elements of risk in excess of the amount recognized in the balance sheet. The Company's exposure to credit loss in the event of nonperformance by counterparties for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and issuing letters of credit as it does for originating loans included on the balance sheet. The following financial instruments represent off-balance-sheet credit risk (dollars in thousands):

	June 30, 2013	December 31, 2012
Commitments to extend credit	$ 387,241	$ 225,400
Standby letters of credit	$ 8,316	$ 6,690
Commercial letters of credit	$ 8,533	$ 8,539

Commitments to extend credit consist primarily of the following: Unfunded home equity lines of credit; commercial real estate construction loans, which are established under standard underwriting guidelines and policies and are secured by deeds of trust, with disbursements made over the course of construction; commercial revolving lines of credit, which have a high degree of industry diversification; the unused portions of mortgage warehouse lines of credit; and the unused portions of formalized (disclosed) deposit account overdraft lines. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many commitments are expected to expire without being drawn upon, the unused portions of committed amounts do not necessarily represent future cash requirements. Standby letters of credit are generally unsecured and are issued by the Company to guarantee the performance of a customer to a third party, while commercial letters of credit represent the Company's commitment to pay a third party on behalf of a customer upon fulfillment of contractual requirements. The credit risk involved in issuing letters of credit is essentially the same as the risk involved in extending loans to customers.

The Company is also utilizing a $79 million letter of credit issued by the Federal Home Loan Bank on the Company's behalf as security for certain deposits. The letter of credit is backed by specific loans which are pledged to the Federal Home Loan Bank by the Company.

Note 9 Fair Value Disclosures and Reporting, the Fair Value Option and Fair Value Measurements

FASB's standards on financial instruments, and on fair value measurements and disclosures, require all entities to disclose in their financial statement footnotes the estimated fair values of financial instruments for which it is practicable to estimate such values. In addition to those disclosure requirements, FASB's standard on investments requires that our debt securities, which are classified as available for sale, and our equity securities that have readily determinable fair values, be measured and reported at fair value in our statement of financial position. Certain impaired loans are also reported at fair value, as explained in greater detail below, and foreclosed assets are carried at the lower of cost or fair value. FASB's standard on financial instruments permits companies to report certain other financial assets and liabilities at fair value, but we have not elected the fair value option for any additional financial assets or liabilities.

Fair value measurements and disclosure standards also establish a framework for measuring fair value. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants on the measurement date. Further, they establish a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standards describe three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the factors that market participants would likely consider in pricing an asset or liability.

Fair value estimates are made at a specific point in time based on relevant market data and information about the financial instruments. The estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to realized gains and losses could have a significant effect on fair value estimates but have not been considered in any estimates. Because no market exists for a significant portion of the Company's financial instruments, fair value disclosures are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. The estimates are subjective and involve uncertainties and matters of significant judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the fair values presented. The following methods and assumptions were used by the Company to estimate the fair value of its financial instruments disclosed at June 30, 2013 and December 31, 2012:

Cash and cash equivalents and fed funds sold: For cash and cash equivalents and fed funds sold, the carrying amount is estimated to be fair value.

Investment securities: The fair values of investment securities are determined by obtaining quoted prices on nationally recognized securities exchanges or by matrix pricing, which is a mathematical technique used widely in the industry to value debt securities by relying on their relationship to other benchmark quoted securities when quoted prices for specific securities are not readily available.

Loans and leases: For variable-rate loans and leases that re-price frequently with no significant change in credit risk or interest rate spread, fair values are based on carrying values. Fair values for other loans and leases are estimated by discounting projected cash flows at interest rates being offered at each reporting date for loans and leases with similar terms, to borrowers of comparable creditworthiness. The carrying amount of accrued interest receivable approximates its fair value.

Loans held for sale: Since loans designated by the Company as available-for-sale are typically sold shortly after making the decision to sell them, realized gains or losses are usually recognized within the same period and fluctuations in fair values are thus not relevant for reporting purposes. If available-for-sale loans stay on our books for an extended period of time, the fair value of those loans is determined using quoted secondary-market prices.

Collateral-dependent impaired loans: Impaired loans carried at fair value are those for which it is probable that the bank will be unable to collect all amounts due according to the contractual terms of the original loan agreement, and the carrying value has been written down to the fair value of the loan. The carrying value is equivalent to the fair value of the collateral, net of expected disposition costs where applicable, for collateral-dependent loans.

Cash surrender value of life insurance policies: The fair values are based on net cash surrender values at each reporting date.

Investments in, and capital commitments to, limited partnerships: The fair values of our investments in WNC Institutional Tax Credit Fund Limited Partnerships and any other limited partnerships are estimated using quarterly indications of value provided by the general partner. The fair values of undisbursed capital commitments are assumed to be the same as their book values.

Other investments: Certain investments for which no secondary market exists are carried at cost unless an impairment analysis indicates the need for adjustments, and the carrying amount for those investments approximates their estimated fair value.

Deposits: Fair values for demand deposits and other non-maturity deposits are equal to the amount payable on demand at the reporting date, which is the carrying amount. Fair values for fixed-rate certificates of deposit are estimated using a cash flow analysis, discounted at interest rates being offered at each reporting date by the Bank for certificates with similar remaining maturities. The carrying amount of accrued interest payable approximates its fair value.

Short-term borrowings: The carrying amounts approximate fair values for federal funds purchased, overnight FHLB advances, borrowings under repurchase agreements, and other short-term borrowings maturing within ninety days of the reporting dates. Fair values of other short-term borrowings are estimated by discounting projected cash flows at the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Long-term borrowings: The fair values of the Company's long-term borrowings are estimated using projected cash flows discounted at the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Subordinated debentures: The fair values of subordinated debentures are determined based on the current market value for like instruments of a similar maturity and structure.

Commitments to extend credit and letters of credit: If funded, the carrying amounts for currently unused commitments would approximate fair values for the newly created financial assets at the funding date. However, because of the high degree of uncertainty with regard to whether or not those commitments will ultimately be funded, fair values for loan commitments and letters of credit in their current undisbursed state cannot reasonably be estimated, and only notional values are disclosed in the table below.

Estimated fair values for the Company's financial instruments at the periods noted are as follows:

Fair Value of Financial Instruments
(dollars in thousands, unaudited)

	June 30, 2013				
		Estimated Fair Value			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial Assets:					
Cash and cash equivalents	$ 66,982	$ 66,982	$ -	$ -	$ 66,982
Investment securities available for sale	393,576	2,234	391,342	-	393,576
Loans and leases, net	785,219	-	831,835	-	831,835
Collateral dependent impaired loans	14,032	-	14,032	-	14,032
Loans held-for-sale	523	523	-	-	523
Cash surrender value of life insurance policies	38,940	-	38,940	-	38,940
Other investments	5,932	-	5,932	-	5,932
Investment in Limited Partnership	9,826	-	9,826	-	9,826
Accrued interest receivable	4,935	-	4,935	-	4,935
Financial Liabilities:					
Deposits:					
Noninterest-bearing	$ 357,540	$ 357,540	$ -	$ -	$ 357,540
Interest-bearing	797,476	-	797,833	-	797,833
Fed Funds Purchased and Repurchase Agreements	1,963	-	1,963	-	1,963
Short-term borrowings	-	-	-	-	-
Long-term borrowings	-	-	-	-	-
Subordinated debentures	30,928	-	19,304	-	19,304
Limited partnership capital commitment	951	-	951	-	951
Accrued Interest Payable	200	-	200	-	200

	Notional Amount
Off-balance-sheet financial instruments:	
Commitments to extend credit	$ 387,241
Standby letters of credit	8,316
Commercial lines of credit	8,533

	December 31, 2012				
		Estimated Fair Value			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial Assets:					
Cash and cash equivalents	$ 61,818	$ 61,818	$ -	$ -	$ 61,818
Investment securities available for sale	380,188	1,809	378,379	-	380,188
Loans and leases, net	839,629	-	873,309	-	873,309
Collateral dependent impaired loans	27,449	-	27,449	-	27,449

Loans held-for-sale		210		210		-		-		210
Cash surrender value of life insurance policies		38,007		-		38,007		-		38,007
Other Investments		6,370		-		6,370		-		6,370
Investment in Limited Partnership		10,316		-		10,316		-		10,316
Accrued Interest Receivable		5,095		-		5,095		-		5,095
Financial Liabilities:										
Deposits:										
Noninterest-bearing	$	352,597	$	352,597	$	-	$	-	$	352,597
Interest-bearing		821,437		-		821,911		-		821,911
Fed Funds Purchased and Repurchase Agreements		1,419		-		1,419		-		1,419
Short-term borrowings		36,650		-		36,650		-		36,650
Long-term borrowings		5,000		-		5,038		-		5,038
Subordinated debentures		30,928		-		12,141		-		12,141
Limited partnership capital commitment		962		-		962		-		962
Accrued Interest Payable		304		-		304		-		304

	Notional Amount	
Off-balance-sheet financial instruments:		
Commitments to extend credit	$	225,400
Standby letters of credit		6,690
Commercial lines of credit		8,539

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For financial asset categories that were actually reported at fair value at June 30, 2013 and December 31, 2012, the Company used the following methods and significant assumptions:

Investment Securities: The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges or by matrix pricing, which is a mathematical technique used widely in the industry to value debt securities by relying on the their relationship to other benchmark quoted securities.

Collateral Dependent Impaired loans: Impaired loans carried at fair value are those for which it is probable that the bank will be unable to collect all amounts due (including both interest and principal) according to the contractual terms of the original loan agreement, and the carrying value has been written down to the fair value of the loan. The carrying value is equivalent to the fair value of the collateral based on current appraisals, net of expected disposition costs where applicable, for collateral-dependent loans.

Foreclosed assets: Repossessed real estate (OREO) and other assets are carried at the lower of cost or fair value. Fair value is the appraised value less expected selling costs for OREO and some other assets such as mobile homes, and for all other assets fair value is represented by the estimated sales proceeds as determined using reasonably available sources. Foreclosed assets for which appraisals can be feasibly obtained are periodically measured for impairment using updated appraisals. Fair values for other foreclosed assets are adjusted as necessary, subsequent to a periodic re-evaluation of expected cash flows and the timing of resolution. If impairment is determined to exist, the book value of a foreclosed asset is immediately written down to its estimated impaired value through the income statement, thus the carrying amount is equal to the fair value and there is no valuation allowance.

Assets reported at fair value on a recurring basis are summarized below:

<u>Fair Value Measurements - Recurring</u>
(dollars in thousands, unaudited)

	Fair Value Measurements at June 30, 2013, Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Investment Securities				
U.S. Government agencies	$ -	$ 4,293	$ -	$ 4,293
Obligations of states and political subdivisions	-	87,405	-	87,405
U.S. Government agencies collateralized by mortgage obligations	-	299,644	-	299,644
Other Securities	2,234	-	-	2,234
Total availabe-for-sale securities	$ 2,234	$ 391,342	$ -	$ 393,576

	Fair Value Measurements at December 31, 2012, Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Investment Securities				
U.S. Government agencies	$ -	$ 2,973	$ -	$ 2,973
Obligations of states and political subdivisions	-	73,986	-	73,986
U.S. Government agencies collateralized by mortgage obligations	-	301,389	-	301,389
Other Securities	1,809	31	-	1,840
Total availabe-for-sale securities	$ 1,809	$ 378,379	$ -	$ 380,188

Assets reported at fair value on a nonrecurring basis are summarized below:

Fair Value Measurements - Nonrecurring
(dollars in thousands, unaudited)

	Fair Value Measurements at June 30, 2013, Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Collateral Dependent Impaired Loans	$ -	$ 14,032	$ -	$ 14,032
Foreclosed Assets	$ -	$ 10,834	$ -	$ 10,834

	Fair Value Measurements at December 31, 2012, Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Collateral Dependent Impaired Loans	$ -	$ 27,449	$ -	$ 27,449
Foreclosed Assets	$ -	$ 19,754	$ -	$ 19,754

The table above only includes collateral-dependent impaired loan balances for which a specific reserve has been established or on which a write-down has been taken. Information on the Company’s total impaired loan balances, and specific loss reserves associated with those balances, is included in Note 11 below, and in Management’s Discussion and Analysis of Financial Condition and Results of Operation in the “Nonperforming Assets” and “Allowance for Loan and Lease Losses” sections.

The unobservable inputs are based on management’s best estimates of appropriate discounts in arriving at fair market value. Increases or decreases in any of those inputs could result in a significantly lower or higher fair value measurement. For example, a change in either direction of actual loss rates would have a directionally opposite change in the calculation of the fair value of unsecured impaired loans.

Note 10 Investments

Although the Company currently has the intent and the ability to hold the securities in its investment portfolio to maturity, the securities are all marketable and are classified as "available for sale" to allow maximum flexibility with regard to interest rate risk and liquidity management. Pursuant to FASB's guidance on accounting for debt and equity securities, available for sale securities are carried on the Company's financial statements at their estimated fair market values, with monthly tax-effected "mark-to-market" adjustments made vis-à-vis accumulated other comprehensive income in shareholders' equity. The Company's available-for-sale investment securities totaled $394 million at June 30, 2013, and $380 million at December 31, 2012.

Amortized Cost And Estimated Fair Value

The amortized cost and estimated fair value of investment securities available-for-sale are as follows (dollars in thousands, unaudited):

	June 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government agencies	$ 4,363	$ 4	$ (74)	$ 4,293
Obligations of state and political subdivisions	87,237	2,138	(1,970)	87,405
U.S. Government agencies collateralized by mortgage obligations	300,565	2,096	(3,017)	299,644
Equity Securities	1,336	898	-	2,234
	$ 393,501	$ 5,136	$ (5,061)	$ 393,576

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government agencies	$ 2,987	$ 3	$ (17)	$ 2,973
Obligations of state and political subdivisions	70,736	3,430	(180)	73,986
U.S. Government agencies collateralized by mortgage obligations	298,806	3,547	(964)	301,389
Equity Securities	1,336	508	(4)	1,840
	$ 373,865	$ 7,488	$ (1,165)	$ 380,188

At June 30, 2013 and December 31, 2012, the Company had 209 securities and 89 securities, respectively, with unrealized losses. Management has evaluated those securities as of the respective dates, and does not believe that any of the associated unrealized losses are other than temporary. Information pertaining to our investment securities with unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous loss position, is disclosed in the table below.

Investment Portfolio - Unrealized Losses
(dollars in thousands, unaudited)

	June 30, 2013			
	Less than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. Government Agencies	$ (74)	$ 2,615	$ -	$ -
Obligations of State and Political Subdivisions	(1,948)	36,167	(22)	309
U.S. Government agencies collateralized by mortgage obligations	(2,786)	179,242	(231)	12,838
Other Securities	-	-	-	-
Total	$ (4,808)	$ 218,024	$ (253)	$ 13,147

	December 31, 2012			
	Less than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. Government Agencies	$ (17)	$ 1,996	$ -	$ -
Obligations of State and Political Subdivisions	(180)	9,324	-	-
U.S. Government agencies collateralized by mortgage obligations	(903)	106,799	(61)	6,965
Other Securities	(4)	242	-	-
Total	$ (1,104)	$ 118,361	$ (61)	$ 6,965

Note 11 Credit Quality and Nonperforming Assets

Credit Quality Classifications

The Company monitors the credit quality of loans on a continuous basis using the regulatory and accounting classifications of pass, special mention, substandard and impaired to characterize the associated credit risk. Balances classified as "loss" are immediately charged off. The Company conforms to the following definitions for risk classifications utilized:

- Pass: Larger non-homogeneous loans not meeting the risk rating definitions below, and smaller homogeneous loans that are not assessed on an individual basis.

- Special Mention: Loans which have potential issues that deserve the close attention of management. If left uncorrected, those potential weaknesses could eventually diminish the prospects for full repayment of principal and interest according to the contractual terms of the loan agreement, or could result in deterioration of the Company's credit position at some future date.

- Substandard: Loans that have at least one clear and well-defined weakness which could jeopardize the ultimate recoverability of all principal and interest, such as a borrower displaying a highly leveraged position, unfavorable financial operating results and/or trends, uncertain repayment sources or a deteriorated financial condition.

- Impaired: A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans include all nonperforming loans, loans classified as restructured troubled debt, and certain other loans that are still being maintained on accrual status. If the Bank grants a concession to a borrower in financial difficulty, the loan falls into the category of a troubled debt restructuring (TDR). A TDR may be nonperforming or performing, depending on its accrual status and the demonstrated ability of the borrower to comply with restructured terms.

Credit quality classifications for the Company's loan balances were as follows, as of the dates indicated:

Credit Quality Classifications
(dollars in thousands, unaudited)

	June 30, 2013				
	Pass	Special Mention	Substandard	Impaired	Total
Real Estate:					
1-4 Family residential construction	$ 1,226	$ 258	$ 131	$ -	$ 1,615
Other construction/Land	14,273	740	370	7,411	22,794
1-4 Family - closed end	67,551	1,329	830	21,775	91,485
Equity Lines	54,288	83	1,896	1,089	57,356
Multi-family residential	5,944	429	-	-	6,373
Commercial real estate - owner occupied	138,154	19,053	6,462	9,627	173,296
Commercial real estate - non-owner occupied	80,269	4,212	409	13,944	98,834
Farmland	99,137	2,080	2,457	456	104,130
Total Real Estate	460,842	28,184	12,555	54,302	555,883
Agricultural	23,005	420	-	20	23,445
Commercial and Industrial	175,595	2,671	323	4,253	182,842
Small Business Administration	14,342	995	1,129	3,027	19,493
Direct finance leases	3,400	27	2	60	3,489
Consumer loans	20,578	299	211	3,954	25,042
Total Gross Loans and Leases	$ 697,762	$ 32,596	$ 14,220	$ 65,616	$ 810,194

	December 31, 2012				
	Pass	Special Mention	Substandard	Impaired	Total
Real Estate:					
1-4 Family residential construction	$ 1,599	$ 1,333	$ 89	$ 153	$ 3,174
Other construction/Land	13,270	952	1,132	12,648	28,002
1-4 Family - closed end	73,003	2,484	1,208	23,222	99,917
Equity Lines	58,160	96	1,949	1,258	61,463
Multi-family residential	5,351	609	-	-	5,960
Commercial real estate - owner occupied	144,207	22,895	6,562	8,950	182,614
Commercial real estate - non-owner occupied	67,407	6,864	568	17,969	92,808
Farmland	64,176	2,216	3,526	1,933	71,851
Total Real Estate	427,173	37,449	15,034	66,133	545,789
Agricultural	21,333	462	24	663	22,482
Commercial and Industrial	248,157	5,020	1,845	3,656	258,678
Small Business Administration	15,002	1,551	743	3,227	20,523
Direct finance leases	4,076	22	-	135	4,233
Consumer loans	23,099	445	198	4,348	28,090
Total Gross Loans and Leases	$ 738,840	$ 44,949	$ 17,844	$ 78,162	$ 879,795

Past Due and Nonperforming Assets

Nonperforming assets are comprised of loans for which the Company is no longer accruing interest, and foreclosed assets, including mobile homes and other real estate owned ("OREO"). OREO consists of properties acquired by foreclosure or similar means, which the Company is offering or will offer for sale. Nonperforming loans and leases result when reasonable doubt surfaces with regard to the ability of the Company to collect all principal and interest. At that point, we stop accruing interest on the loan or lease in question, and reverse any previously-recognized interest to the extent that it is uncollected or associated with interest-reserve loans. Any asset for which principal or interest has been in default for 90 days or more is also placed on non-accrual status, even if interest is still being received, unless the asset is both well secured and in the process of collection. An aging of the Company's loan balances, by number of days past due as of the indicated dates, is presented in the following tables:

Loan Portfolio Aging
(dollars in thousands, unaudited)

June 30, 2013

	30-59 Days Past Due	60-89 Days Past Due	90 Days Or More Past Due(2)	Total Past Due	Current	Total Financing Receivables	Non-Accrual Loans(1)
Real Estate:							
1-4 Family residential construction	$ -	$ -	$ -	$ -	$ 1,615	$ 1,615	$ -
Other construction/Land	263	159	103	525	22,269	22,794	6,160
1-4 Family - closed end	372	514	1,199	2,085	89,400	91,485	15,162
Equity Lines	22	-	401	423	56,933	57,356	887
Multi-family residential	-	-	-	-	6,373	6,373	-
Commercial real estate - owner occupied	4,276	1,022	2,710	8,008	165,288	173,296	6,844
Commercial real estate - non-owner occupied	197	3,424	7,291	10,912	87,922	98,834	7,713
Farmland	122	-	-	122	104,008	104,130	455
Total Real Estate	5,252	5,119	11,704	22,075	533,808	555,883	37,221
Agricultural	248	-	-	248	23,197	23,445	21
Commercial and Industrial	842	218	900	1,960	180,882	182,842	1,836
Small Business Administration	939	116	1,363	2,418	17,075	19,493	1,996
Direct finance leases	27	60	2	89	3,400	3,489	60
Consumer loans	134	80	92	306	24,736	25,042	1,175
Total Gross Loans and Leases	$ 7,442	$ 5,593	$ 14,061	$ 27,096	$ 783,098	$ 810,194	$ 42,309

(1) Included in Total Financing Receivables
(2) Includes finance lease loans over 90 days past due and still accruing in the amount of $2,122.

December 31, 2012

	30-59 Days Past Due	60-89 Days Past Due	90 Days Or More Past Due(2)	Total Past Due	Current	Total Financing Receivables	Non-Accrual Loans(1)
Real Estate:							
1-4 Family residential construction	$ -	$ -	$ 153	$ 153	$ 3,021	$ 3,174	$ 153
Other construction/Land	374	211	-	585	27,417	28,002	11,163
1-4 Family - closed end	1,335	88	376	1,799	98,118	99,917	15,381
Equity Lines	473	40	66	579	60,884	61,463	1,026
Multi-family residential	177	-	-	177	5,783	5,960	-
Commercial real estate - owner occupied	1,372	813	1,289	3,474	179,140	182,614	5,314
Commercial real estate - non - owner occupied	7,831	-	1,499	9,330	83,478	92,808	11,642
Farmland	231	-	1,679	1,910	69,941	71,851	1,933
Total Real Estate	11,793	1,152	5,062	18,007	527,782	545,789	46,612
Agricultural	24	157	506	687	21,795	22,482	664
Commercial and Industrial	1,419	518	7	1,944	256,734	258,678	2,386
Small Business Administration	905	-	1,574	2,479	18,044	20,523	2,159

Direct finance leases	-	34	123	157	4,076	4,233	135
Consumer loans	238	189	87	514	27,576	28,090	1,138
Total Gross Loans and Leases	$ 14,379	$ 2,050	$ 7,359	$ 23,788	$ 856,007	$ 879,795	$ 53,094

(1) Included in Total Financing Receivables
(2) As of December 31, 2012 there were no loans over 90 days past due and still accruing.

Troubled Debt Restructurings

A loan that is modified for a borrower who is experiencing financial difficulty is classified as a troubled debt restructuring ("TDR"), if the modification constitutes a concession. At June 30, 2013, the Company had a total of $43.8 million in TDR's, including $26.1 million in TDR's that were on non-accrual status. Generally, a non-accrual loan that has been modified as a TDR remains on non-accrual status for a period of at least six months to demonstrate the borrower's ability to comply with the modified terms. However, performance prior to the modification, or significant events that coincide with the modification, could result in a loan's return to accrual status after a shorter performance period or even at the time of loan modification. TDR's may have the TDR designation removed in the calendar year following the restructuring, if the loan is in compliance with all modified terms and is yielding a market rate of interest. Regardless of the period of time that has elapsed, if the borrower's ability to meet the revised payment schedule is uncertain then the loan will be kept on non-accrual status. Moreover, a TDR is generally considered to be in default when it appears that the customer will not likely be able to repay all principal and interest pursuant to the terms of the restructured agreement.

The Company may agree to different types of concessions when modifying a loan or lease. The tables below summarize TDR's which were modified during the noted periods, by type of concession:

<u>Troubled Debt Restructurings, by Type of Loan Modification</u>
(dollars in thousands, unaudited)

	For the Six Months Ended June 30, 2013							
	Rate Modification	Term Modification	Interest Only Modification	Rate & Term Modification	Rate & Interest Only Modification	Term & Interest Only Modification	Rate, Term & Interest Only Modification	Total
Trouble Debt Restructurings								
Real Estate:								
Other construction/Land	$ -	$ 247	$ -	$ -	$ -	$ -	$ -	$ 247
1-4 family - closed-end	-	3,338	-	30	-	-	-	3,368
Commercial real estate - owner occupied	-	-	-	-	-	-	-	-
Commercial real estate - non-owner occupied	-	-	-	-	-	-	-	-
Total Real Estate Loans	-	3,585	-	30	-	-	-	3,615
Commercial and Industrial	-	1,507	-	-	-	-	-	1,507
Consumer loans	-	284	-	-	-	-	-	284
Small Business Administration Loans	-	-	-	-	-	-	-	-
	$ -	$ 5,376	$ -	$ 30	$ -	$ -	$ -	$ 5,406

	For the Year Ended December 31, 2012							
	Rate Modification	Term Modification	Interest Only Modification	Rate & Term Modification	Rate & Interest Only Modification	Term & Interest Only Modification	Rate, Term & Interest Only Modification	Total
Trouble Debt Restructurings								
Real Estate:								
Other construction/Land	$ -	$ 458	$ -	$ 375	$ -	$ -	$ -	$ 833
1-4 family - closed-end	-	313	-	200	-	222	616	1,351
Equity Lines	-	29	-	-	-	-	-	29
Commercial real estate - owner occupied	-	1,006	-	1,184	-	-	-	2,190
Commercial real estate - non-owner occupied	-	330	-	60	-	-	-	390
Total Real Estate Loans	-	2,136	-	1,819	-	222	616	4,793
Commercial and Industrial	-	625	2	658	-	-	-	1,285
Consumer loans	-	1,328	-	269	-	-	117	1,714
Small Business Administration Loans	-	200	-	475	-	-	-	675
	$ -	$ 4,289	$ 2	$ 3,221	$ -	$ 222	$ 733	$ 8,467

The following tables present, by class, additional details related to loans classified as TDR's during the referenced periods, including the recorded investment in the loan both before and after modification and balances that were modified during the period:

Troubled Debt Restructurings
(dollars in thousands, unaudited)

	For the Three Months Ended June 30, 2013				
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Reserve Difference[1]	Reserve
Real Estate:					
Other Construction/Land	-	$ -	$ -	$ -	$ -
1-4 family - closed-end	2	129	129	17	17
Commercial RE- owner occupied	-	-	-	-	-
Commercial RE- non-owner occupied	-	-	-	-	-
Total Real Estate Loans		129	129	17	17
Commercial and Industrial	1	50	50	18	20
Small Business Administration Loans	-	-	-	-	-
Consumer loans	2	20	20	2	6
		$ 199	$ 199	$ 37	$ 43

[1] This represents the change in the ALL reserve for these credits measured as the difference between the specific post-modification impairment reserve and the pre-modification reserve calculated under our general allowance for loan loss methodology.

	For the Six Months Ended June 30, 2013				
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Reserve Difference[1]	Reserve
Real Estate:					
Other Construction/Land	1	$ 249	$ 247	$ 6	$ -
1-4 family - closed-end	3	3,369	3,368	17	17
Commercial RE- owner occupied	-	-	-	-	-
Commercial RE- non-owner occupied	-	-	-	-	-
Total Real Estate Loans		3,618	3,615	23	17
Commercial and Industrial	4	1,507	1,507	(20)	69
Small Business Administration Loans	-	-	-	-	-
Consumer loans	7	284	284	33	38
		$ 5,409	$ 5,406	$ 36	$ 124

[1]This represents the change in the ALL reserve for these credits measured as the difference between the specific post-modification impairment reserve and the pre-modification reserve calculated under our general allowance for loan loss methodology.

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The table below summarizes TDR's that defaulted during the period noted, and any charge-offs on those TDR's resulting from such default.

Troubled Debt Restructurings
(dollars in thousands, unaudited)

	Subsequent default three months ended June 30, 2013		
	Number of Loans	Recorded Investment	Charge-Offs
Real Estate:			
Other Construction/Land	-	$ -	$ -
1-4 family - closed-end	2	779	94
Equity Lines	-	-	-
Commercial real estate- owner occupied	1	308	210
Total Real Estate Loans		1,087	304
Commercial and Industrial	2	65	-
Small Business Administration Loans	-	-	-
Consumer Loans	3	65	64
		$ 1,217	$ 368

	Subsequent default six months ended June 30, 2013		
	Number of Loans	Recorded Investment	Charge-Offs
Real Estate:			
Other Construction/Land	1	$ 152	$ 47
1-4 family - closed-end	2	779	94
Equity Lines	-	-	-
Commercial real estate- owner occupied	1	308	210
Total Real Estate Loans		1,239	351
Commercial and Industrial	5	239	174
Small Business Administration Loans	-	-	-
Consumer Loans	4	67	66
		$ 1,545	$ 591

Note 12 Allowance for Loan and Lease Losses

The allowance for loan and lease losses, a contra-asset, is established through a provision for loan and lease losses. It is maintained at a level that is considered adequate to absorb probable losses on certain specifically identified loans, as well as probable incurred losses inherent in the remaining loan portfolio. Specifically identifiable and quantifiable losses are immediately charged off against the allowance; recoveries are generally recorded only when cash payments are received subsequent to the charge off. We employ a systematic methodology, consistent with FASB guidelines on loss contingencies and impaired loans, for determining the appropriate level of the allowance for loan and lease losses and adjusting it at least quarterly. Pursuant to that methodology, impaired loans and leases are individually analyzed and a criticized asset action plan is completed specifying the financial status of the borrower and, if applicable, the characteristics and condition of collateral and any associated liquidation plan. A specific loss allowance is created for each impaired loan, if necessary. The following tables disclose the unpaid principal balance, recorded investment (including accrued interest), average recorded investment, and interest income recognized for impaired loans on our books as of the dates indicated. Balances are shown by loan type, and are further broken out by those that required an allowance and those that did not, with the associated allowance disclosed for those that required such. Included in the valuation allowance for impaired loans shown in the tables below are specific reserves allocated to TDR's, totaling $4.408 million at June 30, 2013 and $4.140 million at December 31, 2012.

Impaired Loans

(dollars in thousands, unaudited)	June 30, 2013				
	Unpaid Principal Balance[1]	Recorded Investment[2]	Related Allowance	Average Recorded Investment	Interest Income Recognized[3]
With an Allowance Recorded					
Real Estate:					
1-4 family residential construction	$ -	$ -	$ -	$ -	$ -
Other Construction/Land	5,619	5,619	1,290	5,666	46
1-4 Family - closed-end	15,901	15,901	1,338	15,959	209
Equity Lines	496	496	54	497	7
Commercial real estate- owner occupied	5,765	4,473	462	4,500	83
Commercial real estate- non-owner occupied	6,390	6,230	1,301	6,298	182
Farmland	-	-	-	-	-
Total Real Estate	34,171	32,719	4,445	32,920	527
Agriculture	-	-	-	-	-
Commercial and Industrial	1,944	1,908	744	1,984	44
Small Business Administration	2,450	2,255	1,147	2,254	29
Direct finance leases	60	60	30	60	-
Consumer loans	3,969	3,902	784	3,995	90
	42,594	40,844	7,150	41,213	690
With no Related Allowance Recorded					
Real Estate:					
1-4 family residential construction	$ -	$ -	$ -	$ -	$ -
Other Construction/Land	1,879	1,792	-	2,636	-
1-4 Family - closed-end	6,597	5,874	-	6,209	-
Equity Lines	760	593	-	594	-
Commercial real estate- owner occupied	5,560	5,154	-	5,183	-
Commercial real estate- non-owner occupied	7,832	7,714	-	7,719	-
Farmland	456	456	-	460	-
Total Real Estate	23,084	21,583	-	22,801	-
Agriculture	21	20	-	22	-
Commercial and Industrial	2,463	2,345	-	2,470	24
Small Business Administration	1,100	772	-	773	-
Direct finance leases	-	-	-	-	-
Consumer loans	181	52	-	60	-
	26,849	24,772	-	26,126	24
Total	$ 69,443	$ 65,616	$ 7,150	$ 67,339	$ 714

[1]Contractual principal balance due from customer.

[2]Principal balance on Company's books, less any direct charge offs.

(3)Interest income is recognized on performing balances on a regular accrual basis.

	December 31, 2012 Unpaid Principal Balance[(1)]	Recorded Investment[(2)]	Related Allowance	Average Recorded Investment	Interest Income Recognized[(3)]
With an Allowance Recorded					
Real Estate:					
1-4 family residential construction	$ 153	$ 153	$ 23	$ 91	$ -
Other Construction/Land	10,313	10,313	1,244	10,755	86
1-4 Family - closed-end	19,218	18,910	955	19,024	401
Equity Lines	1,142	1,142	163	1,144	9
Commercial real estate- owner occupied	5,846	5,585	563	5,666	126
Commercial real estate- non-owner occupied	18,539	17,579	1,230	18,079	481
Farmland	254	254	2	259	-
Total Real Estate	55,465	53,936	4,180	55,018	1,103
Agriculture	28	28	28	28	-
Commercial and Industrial	2,955	2,920	934	3,100	51
Small Business Administration	2,704	2,507	1,038	2,507	53
Direct finance leases	135	135	67	135	-
Consumer loans	4,349	4,344	878	4,493	183
	65,636	63,870	7,125	65,281	1,390
With no Related Allowance Recorded					
Real Estate:					
1-4 family residential construction	$ -	$ -	$ -	$ -	$ -
Other Construction/Land	2,335	2,335	-	2,346	-
1-4 Family - closed-end	4,312	4,312	-	4,491	-
Equity Lines	116	116	-	155	1
Commercial real estate- owner occupied	4,298	3,365	-	3,540	-
Commercial real estate- non-owner occupied	390	390	-	421	3
Farmland	1,679	1,679	-	1,686	-
Total Real Estate	13,130	12,197	-	12,639	4
Agriculture	1,008	635	-	1,017	-
Commercial and Industrial	735	736	-	740	-
Small Business Administration	1,008	720	-	720	-
Direct finance leases	-	-	-	-	-
Consumer loans	4	4	-	7	-
	15,885	14,292	-	15,123	4
Total	$ 81,521	$ 78,162	$ 7,125	$ 80,404	$ 1,394

(1)Contractual principal balance due from customer.
(2)Principal balance on Company's books, less any direct charge offs.
(3)Interest income is recognized on performing balances on a regular accrual basis.

Similar but condensed information is provided in the following table, as of the dates noted:

Impaired Loans
(dollars in thousands, unaudited)

	June 30, 2013		December 31, 2012	
Impaired loans without a valuation allowance	$	24,772	$	14,292
Impaired loans with a valuation allowance	$	40,844	$	63,870
Total impaired loans [1]	$	65,616	$	78,162
Valuation allowance related to impaired loans	$	7,150	$	7,125
Total non-accrual loans	$	42,309	$	53,094
Total loans past-due ninety days or more and still accruing	$	2	$	-

(1) Principal balance on Company's books less any direct charge-off

The specific loss allowance for an impaired loan generally represents the difference between the face value of the loan and either the fair value of underlying collateral less estimated disposition costs, or the loan's net present value as determined by a discounted cash flow analysis. The discounted cash flow approach is typically used to measure impairment on loans for which it is anticipated that repayment will be provided from cash flows other than those generated solely by the disposition or operation of underlying collateral. However, historical loss rates may be used to determine a specific loss allowance if they indicate a higher potential reserve need than the discounted cash flow analysis. Any change in impairment attributable to the passage of time is accommodated by adjusting the loss allowance accordingly.

For loans where repayment is expected to be provided by the disposition or operation of the underlying collateral, impairment is measured using the fair value of the collateral. If the collateral value, net of the expected costs of disposition where applicable, is less than the loan balance, then a specific loss reserve is established for the shortfall in collateral coverage. If the discounted collateral value is greater than or equal to the loan balance, no specific loss reserve is required. At the time a collateral-dependent loan is designated as nonperforming, a new appraisal is ordered and typically received within 30 to 60 days if a recent appraisal is not already available. We generally use external appraisals to determine the fair value of the underlying collateral for nonperforming real estate loans, although the Company's licensed staff appraisers may update older appraisals based on current market conditions and property value trends. Until an updated appraisal is received, the Company uses the existing appraisal to determine the amount of the specific loss allowance that may be required, and adjusts the specific loss allowance, as necessary, once a new appraisal is received. Updated appraisals are generally ordered at least annually for collateral-dependent loans that remain impaired. Current appraisals were available for 92% of the Company's impaired real estate loan balances at June 30, 2013. Furthermore, the Company analyzes collateral-dependent loans on at least a quarterly basis, to determine if any portion of the recorded investment in such loans can be identified as uncollectible and would therefore constitute a confirmed loss. All amounts deemed to be uncollectible are promptly charged off against the Company's allowance for loan and lease losses, with the loan then carried at the fair value of the collateral, as appraised, less estimated costs of disposition if applicable. Once a charge-off or write-down is recorded, it will not be restored to the loan balance on the Company's accounting books.

Our methodology also provides that a "general" allowance be established for probable incurred losses inherent in loans and leases that are not impaired. Unimpaired loan balances are segregated by credit quality, and are then evaluated in pools with common characteristics. At the present time, pools are based on the same segmentation of loan types presented in our regulatory filings. While this methodology utilizes historical loss data and other measurable information, the classification of loans and the establishment of the allowance for loan and lease losses are both to some extent based on management's judgment and experience. Our methodology incorporates a variety of risk considerations, both quantitative and qualitative, in establishing an allowance for loan and lease losses that management believes is appropriate at each reporting date. Quantitative information includes our historical loss experience, delinquency and charge-off trends, and current collateral values. Qualitative factors include the general economic environment in our markets and, in particular, the condition of the agricultural industry and other key industries in the Central San Joaquin Valley. Lending policies and procedures (including underwriting standards), the experience and abilities of lending staff, the quality of loan review, credit concentrations (by geography, loan type, industry and collateral type), the rate of loan portfolio growth, and changes in legal or regulatory requirements are additional factors that are considered. The total general reserve established for probable incurred losses on unimpaired loans was $5.0 million at June 30, 2013.

During the three months ended June 30, 2013, there were no material changes to the methodology used to determine our allowance for loan and lease losses. As we add new products and expand our geographic coverage, and as the economic environment changes, we expect to continue to enhance our methodology to keep pace with the size and complexity of the loan and lease portfolio and respond to pressures created by external forces. We engage outside firms on a regular basis to assess our methodology and perform independent credit reviews of our loan and lease portfolio. In addition, the Company's external auditors, the FDIC, and the California DFI review the allowance for loan and lease losses as an integral part of their audit and examination processes. Management believes that the current methodology is appropriate given our size and level of complexity. The tables that follow detail the activity in the allowance for loan and lease losses for the periods noted:

Note 13 Recent Developments

On July 2, 2013, the Federal Reserve Board approved final rules that implement changes to the regulatory capital framework for financial institutions. The new rules include, among other things, the following elements:

1) a new regulatory capital component referred to as “Common Equity Tier 1 capital”, and threshold ratios for this new component;
2) a “capital conservation buffer” above the minimum required level of Common Equity Tier 1 capital, and restrictions on dividend payments, share buybacks, and certain discretionary bonus payments to executive officers if a capital conservation buffer of at least 2.5% of risk-weighted assets is not achieved;
3) the inclusion of accumulated other comprehensive income (AOCI) in Tier 1 capital, although banks with less than $250 billion in total assets will be allowed a one-time opt-out from this requirement;
4) additional constraints on the inclusion of minority interests, mortgage servicing assets, and deferred tax assets in regulatory capital;
5) increased risk-weightings for certain assets, including equity exposures, certain acquisition/development and construction loans, and certain loans that are more than 90-days past due or are on non-accrual status; and
6) an increase in minimum required risk-based capital ratios over a phase-in period, and an increase in the threshold for a “well-capitalized” classification for the Tier 1 Risk-Based Capital Ratio.

These changes will be phased in beginning January 2015, and our preliminary estimates indicate that we are well-positioned to absorb the impact without constraining organic growth plans, although no assurance can be provided in that regard.

Allowance for Credit Losses and Recorded Investment in Financing Receivables
(dollars in thousands, unaudited)

For the Three Months Ended June 30, 2013

	Real Estate	Agricultural Products	Commercial and Industrial	Small Business Administration	Direct Finance Leases	Consumer	Total
Allowance for credit losses:							
Beginning Balance	$ 6,488	$ 404	$ 3,084	$ 1,410	$ 85	$ 1,728	$ 13,199
Charge-offs	(1,138)	-	(424)	(7)	(86)	(298)	(1,953)
Recoveries	139	-	291	1	4	49	484
Provision	1,368	(342)	(805)	246	36	(53)	450
Ending Balance	$ 6,857	$ 62	$ 2,146	$ 1,650	$ 39	$ 1,426	$ 12,180

For the Six Months Ended June 30, 2013

	Real Estate	Agricultural Products	Commercial and Industrial	Small Business Administration	Direct Finance Leases	Consumer	Total
Allowance for credit losses:							
Beginning Balance	$ 8,034	$ 258	$ 2,797	$ 1,246	$ 165	$ 1,373	$ 13,873
Charge-offs	(2,560)	(28)	(1,315)	(44)	(106)	(605)	(4,658)
Recoveries	304	-	529	1	5	76	915
Provision	1,079	(168)	135	447	(25)	582	2,050
Ending Balance	$ 6,857	$ 62	$ 2,146	$ 1,650	$ 39	$ 1,426	$ 12,180
Reserves:							
Specific	$ 4,445	$ -	$ 744	$ 1,147	$ 30	$ 784	$ 7,150
General	2,412	62	1,402	503	9	642	5,030
Ending Balance	$ 6,857	$ 62	$ 2,146	$ 1,650	$ 39	$ 1,426	$ 12,180
Loans evaluated for impairment:							
Individually	$ 54,302	$ 20	$ 4,253	$ 3,027	$ 60	$ 3,954	$ 65,616
Collectively	501,581	23,425	178,589	16,466	3,429	21,088	744,578
Ending Balance	$ 555,883	$ 23,445	$ 182,842	$ 19,493	$ 3,489	$ 25,042	$ 810,194

For the Year Ended December 31, 2012

	Real Estate	Agricultural Products	Commercial and Industrial	Small Business Administration	Direct Finance Leases	Consumer	Total
Allowance for credit losses:							
Beginning Balance	$ 8,260	$ 19	$ 4,638	$ 1,447	$ 311	$ 2,608	$ 17,283
Charge-offs	(11,108)	(634)	(4,283)	(753)	(198)	(1,802)	(18,778)

Recoveries	302	-	589	95	-	172	1,158
Provision	10,580	873	1,853	457	52	395	14,210
Ending Balance	$ 8,034	$ 258	$ 2,797	$ 1,246	$ 165	$ 1,373	$ 13,873
Reserves:							
Specific	$ 4,180	$ 28	$ 934	$ 1,038	$ 67	$ 878	$ 7,125
General	3,854	230	1,863	208	98	495	6,748
Ending Balance	$ 8,034	$ 258	$ 2,797	$ 1,246	$ 165	$ 1,373	$ 13,873
Loans evaluated for impairment:							
Individually	$ 66,133	$ 663	$ 3,656	$ 3,227	$ 135	$ 4,348	$ 78,162
Collectively	479,656	21,819	255,022	17,296	4,098	23,742	801,633
Ending Balance	$ 545,789	$ 22,482	$ 258,678	$ 20,523	$ 4,233	$ 28,090	$ 879,795

PART I - FINANCIAL INFORMATION

ITEM 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This Form 10-Q includes forward-looking statements that involve inherent risks and uncertainties. Words such as "expects", "anticipates", "believes", "projects", and "estimates" or variations of such words and similar expressions are intended to identify forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed, forecast in, or implied by such forward-looking statements.

A variety of factors could have a material adverse impact on the Company's financial condition or results of operations, and should be considered when evaluating the potential future financial performance of the Company. They include, but are not limited to, persistent sluggish economic conditions in the Company's service areas; risks associated with fluctuations in interest rates; liquidity risks; increases in nonperforming assets and net credit losses that could occur, particularly in times of weak economic conditions or rising interest rates; the Company's ability to secure buyers for foreclosed properties; declines in the market value of available-for-sale securities that could result if interest rates change substantially or an issuer has real or perceived financial difficulties; the Company's ability to attract and retain skilled employees; the Company's ability to successfully deploy new technology; the success of branch expansion; and risks associated with the multitude of current and prospective laws and regulations to which the Company is and will be subject.

CRITICAL ACCOUNTING POLICIES

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States. The financial information and disclosures contained within those statements are significantly impacted by Management's estimates and judgments, which are based on historical experience and various other assumptions that are believed to be reasonable under current circumstances. Actual results may differ from those estimates under divergent conditions.

Critical accounting policies are those that involve the most complex and subjective decisions and assessments, and have the greatest potential impact on the Company's stated results of operations. In Management's opinion, the Company's critical accounting policies deal with the following areas: the establishment of the Company's allowance for loan and lease losses, as explained in detail in Note 12 to the consolidated financial statements and the "Provision for Loan and Lease Losses" and "Allowance for Loan and Lease Losses" sections of this discussion and analysis; the valuation of impaired loans and foreclosed assets, which is discussed in Note 11 to the consolidated financial statements and in the "Nonperforming Assets" and "Allowance for Loan and Lease Losses" sections of this discussion and analysis; income taxes, especially with regard to the ability of the Company to recover deferred tax assets, as discussed in the "Provision for Income Taxes" and "Other Assets" sections of this discussion and analysis; and goodwill, which is evaluated annually for impairment based on the fair value of the Company as discussed in the "Other Assets" section of this discussion and analysis. Critical accounting areas are evaluated on an ongoing basis to ensure that the Company's financial statements incorporate the most recent expectations with regard to those areas.

OVERVIEW OF THE RESULTS OF OPERATIONS
AND FINANCIAL CONDITION

results of operations Summary

Second Quarter 2013 compared to Second Quarter 2012

Net income for the quarter ended June 30, 2013 was $3.799 million, representing an increase of $1.226 million, or 48%, relative to net income of $2.573 million for the quarter ended June 30, 2012. Basic and diluted earnings per share for the second quarter of 2013 were $0.27, compared to $0.18 basic and diluted earnings per share for the second quarter of 2012. The Company's annualized return on average equity was 8.62% and annualized return on average assets was 1.09% for the quarter ended June 30, 2013, compared to a return on equity of 6.02% and return on assets of 0.76% for the quarter ended June 30, 2012. The primary drivers behind the variance in second quarter net income are as follows:

Net interest income was down $273,000, or 2%, due to a 21 basis point drop in the Company's net interest margin that was partially offset by the impact of a $33 million increase in average interest-earning assets.

The largest impact on the increase in net income in the second quarter of 2013 came from a reduction of $2.710 million, or 86%, in our loan loss provision.

Total non-interest income fell by $100,000, or 2%, due to an increase in pass-through operating costs associated with tax credit investments, which are netted out of non-interest income, partially offset by higher income on bank-owned life insurance (BOLI).

Total non-interest expense increased by $234,000, or 2%, due mainly to an increase in salaries and benefits that was partially offset by a reduction in net OREO expense and other credit-related costs.

The Company's provision for income taxes was 26% of pre-tax income in the second quarter of 2013 and 15% in the second quarter of 2012, with the higher tax provisioning rate for 2013 resulting from an increase in taxable income relative to a slight decline in available tax credits.

First Half 2013 compared to First Half 2012

Net income for the first half of 2013 was $6.132 million, representing an increase of $1.680 million, or 38%, relative to net income of $4.452 million for the first half of 2012. Basic and diluted earnings per share for the first half of 2013 were $0.43, compared to $0.32 basic and diluted earnings per share for the first half of 2012. The Company's annualized return on average equity was 7.04% and annualized return on average assets was 0.89% for the six months ended June 30, 2013, compared to a return on equity of 5.23% and return on assets of 0.66% for the six months ended June 30, 2012. The primary drivers behind the variance in year-to-date net income are as follows:

Net interest income declined $919,000, or 4%, due to a 30 basis point drop in the Company's net interest margin partially offset by a the impact of a $45 million increase in average interest-earning assets.

The loan loss provision was reduced by $3.860 million, or 65%.

Total non-interest income declined by $85,000, or 1%, in the first half of 2013, due primarily to the previously-noted increase in tax credit investment costs and investment gains of $71,000 in the first quarter of 2012, partially offset by an increase in income on bank-owned life insurance (BOLI) and a $100,000 non-recurring signing incentive received in the first quarter of 2013 in conjunction with our conversion to a new merchant processing vendor.

Total non-interest expense increased by only $16,000, as higher personnel expense and increased occupancy costs were largely offset by lower credit-related costs.

The Company's provision for income taxes was 20% of pre-tax income for the first half of 2013, relative to 8% for the first half of 2012.

Financial Condition Summary

June 30, 2013 relative to December 31, 2012

The most significant characteristics of, and changes in, the Company's balance sheet during the first six months of 2013 are outlined below:

The Company's assets totaled $1.378 billion at June 30, 2013, a drop of $59 million, or 4%, relative to total assets of $1.438 billion at December 31, 2012, due to a $70 million drop in gross loan balances that was partially offset by growth in investment securities and higher cash balances.

Loan volume was largely impacted by a $66 million decline in mortgage warehouse loans resulting from lower credit line utilization, but an $11 million reduction in nonperforming loans also contributed to the decline in total loans.

Total nonperforming assets, including nonperforming loans and foreclosed assets, were reduced by $20 million, or 27%, to $53 million at June 30, 2013 from $73 million at December 31, 2012.

The Company's allowance for loan and lease losses was $12.2 million as of June 30, 2013, a drop of $1.7 million, or 12%, relative to year-end 2012 due mainly to a lower general reserve for unimpaired loans. The ratio of the allowance to gross loans declined slightly to 1.50% at June 30, 2013 from 1.58% at December 31, 2012.

Despite a $6 million drop in the net unrealized gain on investments, investment securities reflect a net increase of $13 million, or 4%, for the first six months of 2013 due primarily to the addition of municipal securities.

Cash and cash equivalents increased by $5 million, or 8%, as the result of higher interest-earning balances in our Federal Reserve Bank account.

Total deposits were down $19 million, or 2%, due to the maturity of a $5 million wholesale brokered time deposit and the runoff of $23 million in other time deposits, partially offset by a $9 million increase in non-maturity deposits.

There was no change in the balance of junior subordinated debentures (trust preferred securities), but other interest-bearing liabilities, comprised primarily of Federal Home Loan Bank borrowings, were reduced by a net $41 million, or 95%, during the first six months of 2013.

Total capital increased by about $1 million, or 1%, during the first half of 2013, ending the period with a balance of $175 million. Risk-based capital ratios increased, as well, due in large part to the drop in risk-adjusted assets. Our consolidated total risk-based capital ratio increased to 20.87% at June 30, 2013 from 19.36% at year-end 2012. Our tier one risk-based capital ratio was 19.62% and our tier one leverage ratio was 13.82% at June 30, 2013.

EARNINGS PERFORMANCE

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 non-interest income, which consists mainly of customer service charges and fees but also comes from non-customer sources such as bank-owned life insurance. The majority of the Company's non-interest expenses are operating costs that relate to providing a full range of banking services to our customers.

Net interest income AND NET INTEREST MARGIN

Net interest income continues to decline due to net interest margin compression, dropping by $273,000, or 2%, for the second quarter of 2013 relative to the second quarter of 2012, and by $919,000, or 4%, for the first half of 2013 compared to the first half of 2012. The level of net interest income depends on several factors in combination, including growth in earning assets, yields on earning assets, the cost of interest-bearing liabilities, the relative volume of earning assets and interest-bearing liabilities, and the mix of products which comprise the Company's earning assets, deposits, and other interest-bearing liabilities. Net interest income can also be impacted by the reversal of interest for loans placed on non-accrual status during the reporting period, and by the recovery of interest on loans that had been on non-accrual and were either sold or returned to accrual status.

The following tables show average balances for significant balance sheet categories, and the amount of interest income or interest expense associated with each applicable category for the noted periods. The tables also display the calculated yields on each major component of the Company's investment and loan portfolios, the average rates paid on each key segment of the Company's interest-bearing liabilities, and our net interest margin for the noted periods.

Average Balances and Rates (dollars in thousands, except per share data)	For the Three Months Ended Ended June 30, 2013			For the Three Months Ended Ended June 30, 2012		
	Average Balance [1]	Income/ Expense	Average Rate/Yield [2][3]	Average Balance [1]	Income/ Expense	Average Rate/Yield [2][3]
Assets						
Investments:						
Federal funds sold/Due from time	$ 26,115	$ 16	0.24 %	$ 33,483	$ 22	0.26 %
Taxable	314,191	1,034	1.30 %	344,961	1,722	1.97 %
Non-taxable	86,626	672	4.65 %	76,602	685	5.36 %
Equity	2,143	-	-	1,773	29	6.47 %
Total Investments	429,075	1,722	1.91 %	456,819	2,458	2.43 %
Loans and Leases:[4]						
Agricultural	24,218	248	4.11 %	15,848	189	4.80 %
Commercial	210,376	2,789	5.32 %	139,768	2,001	5.76 %
Real Estate	515,428	7,849	6.11 %	526,267	8,348	6.38 %
Consumer	24,960	442	7.10 %	30,920	555	7.22 %
Direct Financing Leases	3,013	40	5.32 %	4,380	61	5.60 %
Other	45,948	-	-	46,288	-	-
Total Loans and Leases	823,943	11,368	5.53 %	763,471	11,154	5.88 %
Total Interest Earning Assets [5]	1,253,018	13,090	4.30 %	1,220,290	13,612	4.60 %
Other Earning Assets	6,168			6,569		
Non-Earning Assets	139,604			142,796		
Total Assets	$ 1,398,790			$ 1,369,655		
Liabilities and Shareholders' Equity						
Interest Bearing Deposits:						
Demand Deposits	$ 87,828	$ 77	0.35 %	$ 71,736	$ 63	0.35 %
NOW	194,194	95	0.20 %	195,037	140	0.29 %
Savings Accounts	131,341	71	0.22 %	106,422	60	0.23 %
Money Market	70,607	24	0.14 %	80,394	32	0.16 %
CDAR's	13,212	7	0.21 %	18,749	12	0.26 %
Certificates of Deposit<$100,000	91,450	107	0.47 %	100,530	154	0.62 %
Certificates of Deposit≥$100,000	212,486	210	0.40 %	225,730	298	0.53 %
Brokered Deposits	10,000	37	1.48 %	15,000	50	1.34 %
Total Interest Bearing Deposits	811,118	628	0.31 %	813,598	809	0.40 %
Borrowed Funds:						
Federal Funds Purchased	2	-	-	1	-	-
Repurchase Agreements	2,020	3	0.60 %	3,578	6	0.67 %
Short Term Borrowings	12,058	5	0.17 %	12,676	7	0.22 %
Long Term Borrowings	-	-	-	5,000	49	3.94 %
TRUPS	30,928	179	2.32 %	30,928	193	2.51 %
Total Borrowed Funds	45,008	187	1.67 %	52,183	255	1.97 %
Total Interest Bearing Liabilities	856,126	815	0.38 %	865,781	1,064	0.49 %
Demand Deposits	346,866			316,498		

Other Liabilities	19,029				15,589			
Shareholders' Equity	176,769				171,787			
Total Liabilities and Shareholders' Equity	$ 1,398,790				$ 1,369,655			
Interest Income/Interest Earning Assets			4.30	%			4.60	%
Interest Expense/Interest Earning Assets			0.26	%			0.35	%
Net Interest Income and Margin(6)		$ 12,275	4.04	%		$ 12,548	4.25	%

(1) Average balances are obtained from the best available daily or monthly data and are net of deferred fees and related direct costs.

(2) Yields and net interest margin have been computed on a tax equivalent basis utilizing a 34% effective tax rate.

(3) Annualized

(4) Loan costs have been included in the calculation of interest income. Loan costs were approximately $(29) thousand and $(9) thousand for the quarters ended June 30, 2013 and 2012.
Loans are gross of the allowance for possible loan losses.

(5) Non-accrual loans have been included in total loans for purposes of total earning assets.

(6) Net interest margin represents net interest income as a percentage of average interest-earning assets.

Average Balances and Rates (dollars in thousands, except per share data)	For the Six Months Ended June 30, 2013				For the Six Months Ended June 30, 2012			
	Average Balance (1)	Income/ Expense	Average Rate/Yield (2)(3)		Average Balance (1)	Income/ Expense	Average Rate/Yield (2)(3)	
Assets								
Investments:								
Federal funds sold/Due from time	$35,634	$44	0.25	%	$28,633	$37	0.26	
Taxable	312,642	2,179	1.39	%	341,841	3,602	2.08	
Non-taxable	81,593	1,291	4.77	%	74,935	1,352	5.41	
Equity	2,041	17	1.66	%	1,625	33	4.02	
Total Investments	431,910	3,531	1.93	%	447,034	5,024	2.53	
Loans and Leases:(4)								
Agricultural	23,999	481	4.04	%	15,015	361	4.83	
Commercial	208,848	5,471	5.28	%	125,147	3,761	6.04	
Real Estate	505,224	15,323	6.12	%	528,616	16,924	6.44	
Consumer	25,708	916	7.19	%	31,768	1,125	7.12	
Direct Financing Leases	3,140	84	5.39	%	4,635	126	5.47	
Nonperforming Loans	49,518	-	-		50,719	-	-	
Total Loans and Leases	816,437	22,275	5.50	%	755,900	22,297	5.93	
Total Interest Earning Assets (5)	1,248,347	25,806	4.28	%	1,202,934	27,321	4.68	
Other Earning Assets	6,268				6,782			
Non-Earning Assets	141,081				141,154			
Total Assets	$1,395,696				$1,350,870			
Liabilities and Shareholders' Equity								
Interest Bearing Deposits:								
Demand Deposits	$85,470	$152	0.36	%	$68,130	$131	0.39	
NOW	195,894	193	0.20	%	193,649	334	0.35	
Savings Accounts	127,194	136	0.22	%	102,631	117	0.23	
Money Market	73,138	54	0.15	%	80,428	65	0.16	
CDAR's	13,994	20	0.29	%	18,489	27	0.29	
Certificates of Deposit<$100,000	95,897	224	0.47	%	102,078	325	0.64	
Certificates of Deposit≥$100,000	213,778	428	0.40	%	223,133	595	0.54	
Brokered Deposits	11,575	81	1.41	%	15,000	100	1.34	
Total Interest Bearing Deposits	816,940	1,288	0.32	%	803,538	1,694	0.42	
Borrowed Funds:								
Federal Funds Purchased	1	-	-		-	-	-	
Repurchase Agreements	1,836	6	0.66	%	3,266	10	0.62	
Short Term Borrowings	7,051	6	0.17	%	7,236	8	0.22	
Long Term Borrowings	2,100	33	3.17	%	8,956	180	4.04	
TRUPS	30,928	356	2.32	%	30,928	393	2.56	
Total Borrowed Funds	41,916	401	1.93	%	50,386	591	2.36	
Total Interest Bearing Liabilities	858,856	1,689	0.40	%	853,924	2,285	0.54	
Non-interest Bearing Demand Deposits	342,294				308,453			
Other Liabilities	18,841				17,447			
Shareholders' Equity	175,705				171,046			
Total Liabilities and Shareholders' Equity	$1,395,696				$1,350,870			
Interest Income/Interest Earning Assets			4.28	%			4.68	

Interest Expense/Interest Earning Assets		0.28	%		0.38	
Net Interest Income and Margin[6]	$24,117	4.00	%	$25,036	4.30	

[1] Average balances are obtained from the best available daily or monthly data and are net of deferred fees and related direct costs.

[2] Yields and net interest margin have been computed on a tax equivalent basis utilizing a 34% effective tax rate.

[3] Annualized

[4] Loan costs have been included in the calculation of interest income. Loan costs were approximately $32 thousand and $230 thousand for the six months ended June 30, 2013 and 2012.
Loans are gross of the allowance for possible loan losses.

[5] Non-accrual loans have been included in total loans for purposes of total earning assets.

[6] Net interest margin represents net interest income as a percentage of average interest-earning assets.

The Volume and Rate Variances table below sets forth the dollar difference in interest earned or paid for each major category of interest-earning assets and interest-bearing liabilities for the noted periods, and the amount of such change attributable to changes in average balances (volume) or changes in average interest rates. Volume variances are equal to the increase or decrease in average balance multiplied by prior period rates, and rate variances are equal to the increase or decrease in rate times prior period average balances. Variances attributable to both rate and volume changes are calculated by multiplying the change in rate by the change in average balance, and have been allocated to the rate variance. The fact that the first half of 2013 had one less day than the first half of 2012, which was a leap year, also contributed to the decline in net interest income in 2013 (the $138,000 unfavorable variance attributable to one less day in the first half impacted both rate and volume variances in the table below).

Volume & Rate Variances (dollars in thousands)	Three Months Ended June 30, 2013 over 2012 Increase(decrease) due to			Six Months Ended June 30, 2013 over 2012 Increase(decrease) due to		
	Volume	Rate	Net	Volume	Rate	Net
Assets:						
Investments:						
Federal funds sold / Due from time	$ (5)	$ (1)	$ (6)	$ 9	$ (2)	$ 7
Taxable	(154)	(534)	(688)	(308)	(1,115)	(1,423)
Non-taxable[(1)]	90	(103)	(13)	120	(181)	(61)
Equity	6	(35)	(29)	8	(24)	(16)
Total Investments	(63)	(673)	(736)	(171)	(1,322)	(1,493)
Loans and Leases:						
Agricultural	100	(41)	59	216	(96)	120
Commercial	1,011	(223)	788	2,515	(805)	1,710
Real Estate	(172)	(327)	(499)	(749)	(852)	(1,601)
Consumer	(107)	(6)	(113)	(215)	6	(209)
Direct Financing Leases	(19)	(2)	(21)	(41)	(1)	(42)
Total Loans and Leases	814	(600)	214	1,726	(1,748)	(22)
Total Interest Earning Assets	$ 750	$ (1,272)	$ (522)	$ 1,555	$ (3,070)	$ (1,515)
Liabilities						
Interest Bearing Deposits:						
Demand Deposits	$ 14	$ -	$ 14	$ 33	$ (12)	$ 21
NOW	(1)	(44)	(45)	4	(145)	(141)
Savings Accounts	14	(3)	11	28		