Bank of Commerce Holdings
Form 10-Q
May 06, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2016

Commission file number 0-25135

Bank of Commerce Holdings

California	94-2823865
(State or jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
1901 Churn Creek Road Redding, California	96002
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (530) 722-3952

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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of "accelerated filer, large accelerated filer and smaller reporting company" in Rule 12b-2 of the Exchange Act.

(Check One)

Large accelerated filer Accelerated filer Non-accelerated filer 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

Outstanding shares of Common Stock, no par value, as of April 21, 2016: 13,441,606

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets (Unaudited)

March 31, 2016 and December 31, 2015

(Amounts in thousands, except share information)	**March 31, 2016**	**December 31, 2015**
Assets:		
Cash and due from banks	$14,969	$9,730
Interest-bearing deposits in other banks	70,781	41,462
Total cash and cash equivalents	85,750	51,192
Securities available-for-sale, at fair value	174,251	159,030
Securities held-to-maturity, at amortized cost	35,357	35,899
Loans, net of deferred fees and costs	725,228	717,509
Allowance for loan and lease losses	(11,495)	(11,180)
Net loans	713,733	706,329
Premises and equipment, net	15,494	11,072
Other real estate owned	1,011	1,423
Life insurance	22,642	22,485
Deferred tax asset, net	8,389	9,760
Goodwill and core deposit intangibles, net	2,469	—
Other assets	17,987	18,251
Total assets	$1,077,083	$1,015,441
Liabilities and shareholders' equity:		
Liabilities:		
Demand - noninterest bearing	$212,758	$169,507
Demand - interest bearing	392,325	315,658
Savings accounts	105,828	94,503
Certificates of deposit	226,756	224,067

Total deposits	937,667	803,735
Term debt:		
Principal amount	19,839	94,917
Less unamortized debt issuance costs	(213)	(223)
Net term debt	19,626	94,694
Junior subordinated debentures	10,310	10,310
Other liabilities	18,762	16,180
Total liabilities	986,365	924,919
Commitments and contingencies (Note 12)		
Shareholders' equity:		
Common stock, no par value, 50,000,000 shares authorized: 17,161,096 issued; 13,441,606 outstanding as of March 31, 2016 and 13,385,154 outstanding as of December 31, 2015	24,325	24,214
Retained earnings	65,201	66,562
Accumulated other comprehensive income (loss)	1,192	(254)
Total shareholders' equity	90,718	90,522
Total liabilities and shareholders' equity	$1,077,083	$1,015,441

See accompanying notes to consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Operations (Unaudited)

For the three months ended March 31, 2016 and 2015

(Amounts in thousands, except per share information)	**For the Three Months Ended March 31, 2016**	**2015**
Interest income:		
Interest and fees on loans	$8,451	$7,911
Interest on taxable securities	784	945
Interest on tax-exempt securities	594	599
Interest on interest-bearing deposits in other banks	75	71
Total interest income	9,904	9,526
Interest expense:		
Interest on demand deposits	122	116
Interest on savings deposits	45	54
Interest on certificates of deposit	597	591
Interest on term debt	782	349
Interest on junior subordinated debentures	54	47
Total interest expense	1,600	1,157
Net interest income	8,304	8,369
Provision for loan and lease losses	—	—
Net interest income after provision for loan and lease losses	8,304	8,369
Noninterest income:		
Service charges on deposit accounts	72	49
Fees on payroll and benefit processing	160	148
Earnings on cash surrender value - life insurance	156	165
Gain on investment securities, net	94	215
Other income	467	277
Total noninterest income	949	854
Noninterest expense:		
Salaries and related benefits	4,229	3,910
Premises and equipment	789	734
Write-down of other real estate owned	55	—
Federal Deposit Insurance Corporation insurance premium	156	207
Data processing fees	304	242
Professional service fees	436	388
Branch acquisition costs	412	—
Loss on cancellation of interest rate swap	2,325	—
Other expenses	1,295	1,112

Total noninterest expense	10,001	6,593
(Loss) income before provision for income taxes	(748)	2,630
Provision for income taxes	212	829
Net (loss) income	$(960)	$1,801
Less: Preferred stock dividends	—	50
(Loss) income available to common shareholders	$(960)	$1,751
(Loss) earnings per share - basic	$(0.07)	$0.13
Weighted average shares - basic	13,360	13,303
(Loss) earnings per share - diluted	$(0.07)	$0.13
Weighted average shares - diluted	13,360	13,340

See accompanying notes to consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Unaudited)

For the three months ended March 31, 2016 and 2015

(Amounts in thousands)	**For the Three Months Ended March 31, 2016**	**2015**
Net (loss) income	$(960)	$1,801
Available-for-sale securities:		
Unrealized gains arising during the period	209	747
Change in unrealized income tax expense	(86)	(307)
Change in unrealized gains, net of tax	123	440
Reclassification adjustment for realized (gains) included in net income	(94)	(215)
Income tax expense	38	90
Realized (gains), net of tax	(56)	(125)
Net change in unrealized gains on available-for-sale securities	67	315
Held-to-maturity securities:		
Amortization of held-to-maturity fair value adjustment	(29)	(39)
Income tax expense	12	16
Net change in fair value adjustment on securities held-to-maturity, net of tax	(17)	(23)
Derivatives:		
Unrealized losses arising during the period	(348)	(329)
Change in unrealized tax benefit	143	134
Change in unrealized losses, net of tax	(205)	(195)
Reclassification adjustments for losses on derivatives included in net income	2,721	295
Income tax benefit	(1,120)	(121)
Reclassification adjustments for net losses included in net income, net of tax	1,601	174
Net change in unrealized gains (losses) on derivatives	1,396	(21)
Other comprehensive income	1,446	271
Comprehensive income – Bank of Commerce Holdings	$486	$2,072

See accompanying notes to consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Shareholders' Equity

For the twelve months ended December 31, 2015 and three months ended March 31, 2016 (Unaudited)

(Amounts in thousands except per share information)	**Preferred Amount**	**Common Shares**	**Common Stock Amount**	**Retained Earnings**	**Accumulated Other Comp-Income (Loss) Net of Tax**	**Total**
Balance at January 1, 2015	$ 19,931	13,294	$ 23,891	$ 59,867	$ (87)	$ 103,602
Net Income	—	—	—	8,586	—	8,586
Other comprehensive loss, net of tax	—	—	—	—	(167)	(167)
Comprehensive income	—	—	—	—	—	8,419
Dividend on preferred stock	—	—	—	(189)	—	(189)
Dividend on common stock ($0.12 per share)	—	—	—	(1,600)	—	(1,600)
Common stock issued under employee plans and related tax benefit	—	9	36	—	—	36
Stock options exercised	—	39	156	—	—	156
Compensation expense associated with stock options	—	—	42	—	—	42
Compensation expense associated with restricted stock	—	—	89	—	—	89
Preferred stock redemption	(20,000)	—	—	(33)	—	(20,033)
Preferred stock accretion	69	—	—	(69)	—	—
Balance at December 31, 2015 (1)	$ —	13,342	$ 24,214	$ 66,562	$ (254)	$ 90,522

(1) Excludes 43 unvested restricted shares

(Amounts in thousands except per share information)	**Common Shares**	**Common Stock Amount**	**Retained Earnings**	**Accumulated Other Comp-Income (Loss) Net of Tax**	**Total**

Balance at January 1, 2016	13,342	$ 24,214	$ 66,562	$ (254)	$ 90,522
Net loss	—	—	(960)	—	(960)
Other comprehensive income, net of tax	—	—	—	1,446	1,446
Comprehensive income	—	—	—	—	486
Dividend on common stock ($0.03 per share)	—	—	(401)	—	(401)
Common stock issued under employee plans and related tax benefit	25	84	—	—	84
Compensation expense associated with stock options	—	6	—	—	6
Compensation expense associated with restricted stock	—	21	—	—	21
Balance at March 31, 2016 (1)	13,367	$ 24,325	$ 65,201	$ 1,192	$ 90,718

(1) Excludes 75 unvested restricted shares

See accompanying notes to consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

For the three months ended March 31, 2016 and March 31, 2015

(Amounts in thousands)	**For the Three Months Ended March 31, 2016**	**2015**
Cash flows from operating activities:		
Net (loss) income	$(960)	$1,801
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Provision for depreciation and amortization	432	370
Amortization of core deposit intangibles	20	—
Amortization of debt issuance costs	10	—
Compensation expense associated with stock options	6	12
Compensation expense associated with restricted stock	21	20
Net gain on sale of securities available-for-sale	(94)	(215)
Amortization of investment premiums and accretion of discounts, net	431	471
Amortization of held-to-maturity fair value adjustments	(29)	(39)
Loss on cancellation of interest rate swap	2,325	—
(Gain) loss on disposal of fixed assets	(5)	2
Write-down of fixed assets	—	147
Write-down of other real estate owned	55	—
Loss (gain) on sale of other real estate owned	125	(15)
Decrease in deferred income taxes	363	—
Increase in cash surrender value of life insurance	(156)	(165)
(Decrease) increase in deferred compensation and salary continuation plans	(18)	213
Increase in deferred loan fees and costs	(114)	(158)
Decrease in other assets	359	560
Increase (decrease) in other liabilities	5,353	(1,790)
Net cash provided by operating activities	8,123	1,214
Cash flows from investing activities:		
Proceeds from maturities and payments of available-for-sale securities	5,496	7,443
Proceeds from sale of available-for-sale securities	19,934	25,215
Purchases of available-for-sale securities	(40,930)	(12,330)
Proceeds from maturities and payments of held-to-maturity securities	600	240
Investment in qualified affordable housing partnerships	(178)	(462)
Net redemption of Federal Home Loan Bank of San Francisco stock	—	1,263
Loan originations, net of principal repayments	(8,025)	(27,457)
Purchase of loan pools	(11,815)	(20,587)
Repayments on loan pools	12,679	7,503
Purchase of premises and equipment	(659)	(127)

Proceeds from the sale of other real estate owned	232	1,701
Payments to derivative counterparties for the termination of interest rate swaps	(2,578)	—
Acquisition of branches, net of cash paid	142,359	—
Net cash provided by (used in) investing activities	117,115	(17,598)

See accompanying notes to consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited) (Continued)

	For the Three Months Ended March 31,	
(Amounts in thousands)	**2016**	**2015**
Cash flows from financing activities:		
Net increase (decrease) in demand deposits and savings accounts	$6,359	$(35,590)
Net (decrease) increase in certificates of deposit	(21,472)	8,531
Advances on term debt	30,000	65,000
Repayment of term debt	(105,250)	(50,000)
Proceeds from stock options exercised	—	146
Stock issued under employee and director stock purchase plan	84	36
Cash dividends paid on preferred stock	—	(50)
Cash dividends paid on common stock	(401)	—
Net cash used in financing activities	(90,680)	(11,927)
Net increase (decrease) in cash and cash equivalents	34,558	(28,311)
Cash and cash equivalents at beginning of year	51,192	58,422
Cash and cash equivalents at end of period	$85,750	$30,111

See accompanying notes to consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited) (Continued)

For the three months ended March 31, 2016 and March 31, 2015

(Amounts in thousands)	**For the Three Months Ended March 31, 2016**	**2015**
Supplemental disclosures of cash flow activity:		
Cash paid during the period for:		
Income taxes	$ 300	$ 1,400
Interest	$ 1,298	$ 1,160
Supplemental disclosures of non cash investing activities:		
Transfer of loans to other real estate owned	$ —	$ 2,686
Changes in unrealized gain on investment securities available-for-sale	$ 115	$ 535
Changes in net deferred tax asset related to changes in unrealized gain on investment securities available-for-sale	(48)	(220)
Changes in accumulated other comprehensive income due to changes in unrealized gain on investment securities available-for-sale	$ 67	$ 315
Accretion of held-to-maturity from other comprehensive income to interest income	$ (29)	$ (39)
Changes in deferred tax related to accretion of held-to-maturity investment securities	12	16
Changes in accumulated other comprehensive income due to accretion of held-to-maturity investment securities	$ (17)	$ (23)
Changes in unrealized gains on derivatives	$ (348)	$ (329)
Changes in net deferred tax asset related to changes in unrealized loss on derivatives	143	134
Changes in accumulated other comprehensive income due to changes in unrealized loss on derivatives	$ (205)	$ (195)
Reclassification of earnings from loss on derivatives	$ 2,721	$ 295
Changes in net deferred tax asset related to reclassification of earnings from (loss) on derivatives	(1,120)	(121)
Changes in accumulated other comprehensive income due to reclassification of earnings from loss on derivatives	$ 1,601	$ 174
Supplemental disclosures of non cash financing activities:		
Cash dividend declared on common shares and payable after period-end	$ 401	$ 401
Cash dividend declared on preferred shares and payable after period-end	$ —	$ 50
Transactions Related to Acquisition:		
Assets acquired - fair value	$ 155,228	$ —
Goodwill	$ 717	$ —
Liabilities assumed - fair value	$ 149,238	$ —

See accompanying notes to consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Bank of Commerce Holdings (“Company,” “Holding Company,” “we,” or “us”), is a bank holding company (“BHC”) with its principal offices in Redding, California. The Holding Company’s principal business is to serve as a holding company for Redding Bank of Commerce (the “Bank” and together with the Holding Company, the “Company”) which operates under two separate names (Redding Bank of Commerce and Sacramento Bank of Commerce, a division of Redding Bank of Commerce). The Company has an unconsolidated subsidiary in Bank of Commerce Holdings Trust II. The consolidated Balance Sheets as of March 31, 2016 and December 31, 2015, which have been derived from the unaudited interim consolidated financial statements and audited consolidated financial statements, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and note disclosures normally included in annual consolidated financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations, although the Company believes that all adjustments (all of which are normal and recurring in nature) considered necessary for a fair presentation have been included and the disclosures made are adequate to make the information not misleading.

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) and with prevailing practices within the banking and securities industries. In preparing such consolidated financial statements, management is required to make certain estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the dates of the Balance Sheets and the reported amounts of revenues and expenses for the reporting periods. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan and lease losses (“ALLL”), the valuation of goodwill and Other Real Estate Owned (“OREO”), and fair value measurements. Certain amounts for prior periods have been reclassified to conform to the current financial statement presentation. The results of reclassifications are not considered material and have no effect on previously reported net income or shareholders' equity. The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes contained in Bank of Commerce Holdings 2015 Annual Report on Form 10-K. The consolidated results of operations and cash flows for the 2016 interim periods shown in this report are not necessarily indicative of the results for any future interim period or the entire fiscal year.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Holding Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. As of March 31, 2016 and December 31, 2015, the Company had one wholly-owned trust ("Trust") formed in 2005 to issue trust preferred securities and related common securities. The Company has not consolidated the accounts of the Trust in its Consolidated Financial Statements in accordance with Financial Accounting Standards Board Accounting Standards Codification ("FASB") ASC 810, *Consolidation* ("ASC 810"). As a result, the junior subordinated debentures issued by the Company to the Trust are reflected in our *Consolidated Balance Sheets*.

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

In March of 2016, the FASB issued ASU No. 2016-09, *Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. The amendments are intended to improve the accounting for employee share-based payments and affect all organizations that issue share-based payment awards to their employees. Several aspects of the accounting for share-based payment award transactions are simplified, including: (a) income tax consequences; (b) classification of awards as either equity or liabilities; and (c) classification on the statement of cash flows. For public companies, the amendments are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted. We are currently evaluating the impacts of this ASU on our consolidated financial statements.

In May of 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*, which creates Topic 606 and supersedes Topic 605, Revenue Recognition. The core principle of Topic 606 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In general, the new guidance requires companies to use more judgment and make more estimates than under current guidance, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The standard is effective for public entities for interim and annual periods beginning after December 15, 2017 as deferred by ASU No. 2015-14; early adoption is not permitted. For financial reporting purposes, the standard allows for either full retrospective adoption, meaning the standard is applied to all of the periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements with the cumulative effect of initially applying the standard recognized at the date of initial application. We are currently evaluating the provisions of the ASU to determine the potential impact the new standard will have on our consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

NOTE 3. EARNINGS PER SHARE

Basic earnings per share excludes dilution and is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the period, excluding unvested restricted stock awards which do not have voting rights or share in dividends. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that subsequently shared in the earnings of the Holding Company. The computation of diluted earnings per share does not assume conversion, exercise, or contingent issuance of securities that would have an anti-dilutive effect on earnings per share.

The following is a computation of basic and diluted earnings per share for the three months ended March 31, 2016 and 2015.

(Amounts in thousands, except per share information)	**For the Three Months Ended March 31,**	
Earnings Per Share	**2016**	**2015**
Numerators:		
Net (loss) income	$(960)	$1,801
Less:		
Preferred stock dividends	—	50
Net (loss) income available to common shareholders	$(960)	$1,751
Denominators:		
Weighted average number of common shares outstanding - basic	13,360	13,303
Effect of potentially dilutive common shares (1)	0	37
Weighted average number of common shares outstanding - diluted	13,360	13,340
Earnings per common share:		
Basic	$(0.07)	$0.13
Diluted	$(0.07)	$0.13
Anti-dilutive options not included in diluted earnings per share calculation	120,700	124,200
Anti-dilutive restricted shares not included in diluted earnings per share calculation	54,181	22,312

[1] Represents the effects of the assumed exercise of stock options and vesting of non-participating restricted shares. For periods in which a net loss is reported, there is no effect on the calculation of diluted loss per share because the coversion is anti-dilutive.

NOTE 4. SECURITIES

The following table presents the amortized costs, unrealized gains, unrealized losses and approximate fair values of investment securities as of March 31, 2016, and December 31, 2015.

	As of March 31, 2016			
(Amounts in thousands)	**Amortized Cost**	**Gross Unrealized Gain**	**Gross Unrealized Loss**	**Estimated Fair Value**
Available-for-sale securities:				
U.S. government & agencies	$3,841	$ 74	$ —	$3,915
Obligations of state and political subdivisions	59,315	1,998	(25)	61,288
Residential mortgage backed securities and collateralized mortgage obligations	51,830	229	(338)	51,721
Corporate securities	23,841	210	(287)	23,764
Commercial mortgage backed securities	14,690	11	(130)	14,571
Other asset backed securities	19,021	94	(123)	18,992
Total	$172,538	$ 2,616	$ (903)	$174,251
Held-to-maturity securities:				
Obligations of state and political subdivisions	$35,357	$ 1,206	$ (109)	$36,454

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

	As of December 31, 2015			
(Amounts in thousands)	**Amortized Cost**	**Gross Unrealized Gain**	**Gross Unrealized Loss**	**Estimated Fair Value**
Available-for-sale securities:				
U.S. government & agencies	$3,886	$ 57	$ —	$3,943
Obligations of state and political subdivisions	59,332	1,811	(39)	61,104
Residential mortgage backed securities and collateralized mortgage obligations	32,215	192	(270)	32,137
Corporate securities	33,775	194	(191)	33,778
Commercial mortgage backed securities	12,893	10	(134)	12,769
Other asset backed securities	15,331	82	(114)	15,299
Total	$157,432	$ 2,346	$ (748)	$159,030
Held-to-maturity securities:				
Obligations of state and political subdivisions	$35,899	$ 966	$ (220)	$36,645

The following table presents the maturities of investment securities at March 31, 2016.

	Available-For-Sale		Held-To-Maturity	
(Amounts in thousands)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
Amounts maturing in:				
One year or less	$4,455	$4,464	$—	$—
One year through five years	64,660	64,920	1,530	1,574
Five years through ten years	46,566	47,647	16,465	17,080
After ten years	56,857	57,220	17,362	17,800
Total	$172,538	$174,251	$35,357	$36,454

The amortized cost and fair value of residential mortgage backed, collateralized mortgage obligations and commercial mortgage securities are presented by their expected average life, rather than contractual maturity, because the underlying loans may be repaid without prepayment penalties.

The following table presents the fair value of the securities held for pledging, segregated by purpose, as of March 31, 2016.

(Amounts in thousands)	**Pledged**	**Available To Be Pledged**	**Total Held For Pledging Purposes**
Public funds collateral	$ 18,286	$ 10,523	$ 28,809
Federal Home Loan Bank of San Francisco borrowings	—	19,026	19,026
Total	$ 18,286	$ 29,549	$ 47,835

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

The following table presents the cash proceeds from sales of securities and the associated gross realized gains and gross realized losses that have been included in earnings for the three months ended March 31, 2016 and 2015.

	Three Months Ended March 31,	
(Amounts in thousands)	**2016**	**2015**
Proceeds from sales of securities	$19,934	$25,215
Gross realized gains on sales of securities:		
Obligations of state and political subdivisions	$72	$32
Residential mortgage backed securities and collateralized mortgage obligations	—	13
Corporate securities	42	82
Commercial mortgage backed securities	4	4
Other asset backed securities	1	93
Total gross realized gains on sales of securities	119	224
Gross realized losses on sales of securities:		
Residential mortgage backed securities and collateralized mortgage obligations	—	(9)
Corporate securities	(25)	—
Total gross realized losses on sales of securities	(25)	(9)
Gain on investment securities, net	$94	$215

Investment securities that were in an unrealized loss position as of March 31, 2016 and December 31, 2015 are presented in the following tables, based on the length of time individual securities have been in an unrealized loss position. In the opinion of management, these securities are considered only temporarily impaired due to changes in market interest rates or widening of market spreads subsequent to the initial purchase of the securities, and not due to concerns regarding the underlying credit of the issuers or underlying collateral.

	As of March 31, 2016					
	Less Than 12 Months		**12 Months or More**		**Total**	
	Fair	**Unrealized**	**Fair**	**Unrealized**	**Fair**	**Unrealized**

(Amounts in thousands)	**Value**	**Losses**	**Value**	**Losses**	**Value**	**Losses**
Available-for-sale securities:						
Obligations of states and political subdivisions	$5,620	$ (25)	$—	$ —	$5,620	$ (25)
Residential mortgage backed securities and collateralized mortgage obligations	21,511	(173)	7,593	(165)	29,104	(338)
Corporate securities	10,330	(287)	—	—	10,330	(287)
Commercial mortgage backed securities	9,880	(88)	1,543	(42)	11,423	(130)
Other asset backed securities	9,594	(23)	2,043	(100)	11,637	(123)
Total temporarily impaired securities	$56,935	$ (596)	$11,179	$ (307)	$68,114	$ (903)
Held-to-maturity securities:						
Obligations of states and political subdivisions	$2,205	$ (8)	$3,024	$ (101)	$5,229	$ (109)

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

	As of December 31, 2015					
	Less Than 12 Months		12 Months or More		Total	
(Amounts in thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Available-for-sale securities:						
Obligations of states and political subdivisions	$7,682	$ (39)	$—	$ —	$7,682	$ (39)
Residential mortgage backed securities and collateralized mortgage obligations	16,279	(210)	4,931	(60)	21,210	(270)
Corporate securities	18,707	(191)	—	—	18,707	(191)
Commercial mortgage backed securities	7,557	(62)	1,516	(72)	9,073	(134)
Other asset backed securities	4,734	(13)	3,430	(101)	8,164	(114)
Total temporarily impaired securities	$54,959	$ (515)	$9,877	$ (233)	$64,836	$ (748)
Held-to-maturity securities:						
Obligations of states and political subdivisions	$1,513	$ (63)	$4,831	$ (157)	$6,344	$ (220)

At March 31, 2016, 63 securities were in unrealized loss positions and at December 31, 2015, 59 securities were in unrealized loss positions. For the three months ended March 31, 2016, and year ended December 31, 2015 we did not recognize any other-than-temporary impairment losses.

Subsequent Event

On April 28, 2016 AgriBank announced that, on July 15, 2016 it will redeem all of the outstanding principal amount of its $500 million 9.125 percent subordinated notes due July 2019. The subordinated notes will be redeemed at 100% of the principal amount together with all accrued and unpaid interest. AgriBank states that the early redemption of the notes is allowable under the terms of the notes, which is disputed by the note holders. At March 31, 2016 we held $3.2 million par value of these notes at a cost basis of $3.8 million. If the redemption takes place as scheduled our loss will be equal to our unamortized premium at the date of the redemption which is expected to be approximately $539 thousand.

NOTE 5. LOANS

Outstanding loan balances consist of the following at March 31, 2016, and December 31, 2015.

(Amounts in thousands) **Loan Portfolio**	**March 31, 2016**	**December 31, 2015**
Commercial	$ 136,721	$ 132,805
Commercial real estate:		
Real estate - construction and land development	27,554	28,319
Real estate - commercial non-owner occupied	247,840	243,374
Real estate - commercial owner occupied	154,484	156,299
Residential real estate:		
Real estate - residential - Individual Tax Identification Number (“ITIN”)	48,384	49,106
Real estate - residential - 1-4 family mortgage	10,947	11,390
Real estate - residential - equity lines	44,327	45,473
Consumer and other	53,986	49,873
Gross loans	724,243	716,639
Deferred fees and costs	985	870
Loans, net of deferred fees and costs	725,228	717,509
Allowance for loan and lease losses	(11,495)	(11,180)
Net loans	$ 713,733	$ 706,329

Gross loan balances in the table above include net purchase discounts of $2.7 million and $2.3 million as of March 31, 2016, and December 31, 2015, respectively.

Loans are reported as past due when any portion of the principal and interest are not received by the due date. The days past due will continue to increase for each day until full principal and interest are received (i.e. if payment is not received within 30 days of the due date, the loan will be considered 30 days past due; if payment is not received within 60 days of the due date, the loan will be considered 60 days past due, etc.). Loans that become 90 days past due will be placed in nonaccrual status unless well secured and in the process of collection.

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Age analysis of gross loan balances for past due loans, segregated by class of loans, as of March 31, 2016, and December 31, 2015, was as follows.

(Amounts in thousands) **Past Due Loans at March 31, 2016**	**30-59 Days Past Due**	**60-89 Days Past Due**	**Greater Than 90 Days Past Due**	**Total Past Due**	**Current**	**Total**	**Recorded Investment > 90 Days and Accruing**
Commercial	$605	$244	$ 623	$1,472	$135,249	$136,721	$ —
Commercial real estate:							
Real estate - construction and land development	—	—	—	—	27,554	27,554	—
Real estate - commercial non-owner occupied	—	—	1,197	1,197	246,643	247,840	—
Real estate - commercial owner occupied	368	—	—	368	154,116	154,484	—
Residential real estate:							
Real estate - residential - ITIN	728	238	881	1,847	46,537	48,384	—
Real estate - residential - 1-4 family mortgage	—	372	665	1,037	9,910	10,947	—
Real estate - residential - equity lines	291	453	—	744	43,583	44,327	—
Consumer and other	148	65	—	213	53,773	53,986	—
Total	$2,140	$1,372	$ 3,366	$6,878	$717,365	$724,243	$ —

(Amounts in thousands) **Past Due Loans at December 31, 2015**	**30-59 Days Past Due**	**60-89 Days Past Due**	**Greater Than 90 Days Past Due**	**Total Past Due**	**Current**	**Total**	**Recorded Investment > 90 Days and Accruing**
Commercial	$—	$ 30	$ 634	$664	$132,141	$132,805	$ —
Commercial real estate:							
Real estate - construction and land development	—	—	—	—	28,319	28,319	—
Real estate - commercial non-owner occupied	64	—	5,665	5,729	237,645	243,374	—

Real estate - commercial owner occupied	—	—	1,071	1,071	155,228	156,299	—
Residential real estate:							
Real estate - residential - ITIN	1,018	118	850	1,986	47,120	49,106	—
Real estate - residential - 1-4 family mortgage	—	404	871	1,275	10,115	11,390	—
Real estate - residential - equity lines	137	97	—	234	45,239	45,473	—
Consumer and other	150	50	88	288	49,585	49,873	88
Total	$1,369	$699	$9,179	$11,247	$705,392	$716,639	$ 88

A loan is considered impaired when based on current information and events we determine it is probable that we will not be able to collect all amounts due according to the original loan contract, including scheduled interest payments. Generally, when we identify a loan as impaired, we measure the loan for potential impairment using discounted cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral. In these cases, the current fair value of collateral is used, less selling costs.

The starting point for determining the fair value of collateral is through obtaining external appraisals. Generally, external appraisals are updated every six to twelve months. We obtain appraisals from a pre-approved list of independent, third party, local appraisal firms. Approval and addition to the list is based on experience, reputation, character, consistency and knowledge of the respective real estate market. At a minimum, it is ascertained that the appraiser is: (1) currently licensed in the state in which the property is located, (2) is experienced in the appraisal of properties similar to the property being appraised, (3) is actively engaged in the appraisal work, (4) has knowledge of current real estate market conditions and financing trends, (5) is reputable, and (6) is not on Freddie Mac’s nor our Exclusionary List of appraisers and brokers. In certain cases, appraisals will be reviewed by another independent third party to ensure the quality of the appraisal and the expertise and independence of the appraiser.

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Upon receipt and review, an external appraisal is utilized to measure a loan for potential impairment. Our impairment analysis documents the date of the appraisal used in the analysis, whether the officer preparing the report deems it current, and, if not, allows for internal valuation adjustments with justification. Typical justified adjustments might include discounts for continued market deterioration subsequent to appraisal date, adjustments for the release of collateral contemplated in the appraisal, or the value of other collateral or consideration not contemplated in the appraisal. An appraisal over one year old in most cases will be considered stale dated and an updated or new appraisal will be required. Any adjustments from appraised value to net realizable value are detailed and justified in the impairment analysis, which is reviewed and approved by our Chief Credit Officer.

Although an external appraisal is the primary source to value collateral dependent loans, we may also utilize values obtained through purchase and sale agreements, negotiated short sales, broker price opinions, or the sales price of the note. These alternative sources of value are used only if deemed to be more representative of value based on updated information regarding collateral resolution. Impairment analyses are updated, reviewed and approved on a quarterly basis at or near the end of each reporting period. Based on these processes, we do not believe there are significant time lapses for the recognition of additional losses on collateral dependent loans.

The following tables summarize impaired loans by loan class as of March 31, 2016, and December 31, 2015.

	As of March 31, 2016		
(Amounts in thousands)	**Recorded**	**Unpaid Principal**	**Related**
Impaired Loans	**Investment**	**Balance**	**Allowance**
With no related allowance recorded:			
Commercial	$ 1,908	$ 2,232	$ —
Commercial real estate:			
Real estate - commercial non-owner occupied	1,197	1,197	—
Real estate - commercial owner occupied	1,190	1,952	—
Residential real estate:			
Real estate - residential - ITIN	7,282	8,923	—
Real estate - residential - 1-4 family mortgage	1,742	2,543	—
Real estate - residential - equity lines	143	143	—
Total with no related allowance recorded	$ 13,462	$ 16,990	$ —
With an allowance recorded:			
Commercial	$ 695	$ 766	$ 124
Commercial real estate:			

Real estate - commercial non-owner occupied	821	821	32
Real estate - commercial owner occupied	347	347	62
Residential real estate:			
Real estate - residential - ITIN	1,924	1,958	308
Real estate - residential - equity lines	1,822	1,822	530
Consumer and other	31	31	12
Total with an allowance recorded	$ 5,640	$ 5,745	$ 1,068
Subtotal:			
Commercial	$ 2,603	$ 2,998	$ 124
Commercial real estate	3,555	4,317	94
Residential real estate	12,913	15,389	838
Consumer and other	31	31	12
Total impaired loans	$ 19,102	$ 22,735	$ 1,068

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Notes to Consolidated Financial Statements (Unaudited)

(Amounts in thousands) **Impaired Loans**	**As of December 31, 2015** Recorded Investment	Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial	$ 1,282	$ 1,519	$ —
Commercial real estate:			
Real estate - commercial non-owner occupied	5,488	6,226	—
Real estate - commercial owner occupied	1,071	1,794	—
Residential real estate:			
Real estate - residential - ITIN	7,063	8,662	—
Real estate - residential - 1-4 family mortgage	1,775	2,775	—
Real estate - residential - equity lines	142	142	—
Consumer and other	—	—	—
Total with no related allowance recorded	$ 16,821	$ 21,118	$ —
With an allowance recorded:			
Commercial	$ 761	$ 820	$ 122
Commercial real estate:			
Real estate - commercial non-owner occupied	824	824	35
Real estate - commercial owner occupied	350	350	62
Residential real estate:			
Real estate - residential - ITIN	2,044	2,089	321
Real estate - residential - 1-4 family mortgage			
Real estate - residential - equity lines	558	558	279
Consumer and other	32	32	13
Total with an allowance recorded	$ 4,569	$ 4,673	$ 832
Subtotal:			
Commercial	$ 2,043	$ 2,339	$ 122
Commercial real estate	7,733	9,194	97
Residential real estate	11,582	14,226	600
Consumer and other	32	32	13
Total impaired loans	$ 21,390	$ 25,791	$ 832

Had nonaccrual loans performed in accordance with their contractual terms, we would have recognized additional interest income, net of tax, of approximately $84 thousand and $163 thousand for the three months ended March 31, 2016 and 2015, respectively.

Nonaccrual loans, segregated by loan class, were as follows as of March 31, 2016 and December 31, 2015.

(Amounts in thousands) **Nonaccrual Loans**	**March 31, 2016**	**December 31, 2015**
Commercial	$2,563	$ 1,994
Commercial real estate:		
Real estate - commercial non-owner occupied	1,197	5,488
Real estate - commercial owner occupied	1,190	1,071
Residential real estate:		
Real estate - residential - ITIN	3,705	3,649
Real estate - residential - 1-4 family mortgage	1,742	1,775
Real estate - residential - equity lines	1,270	—
Consumer and other	31	32
Total	$11,698	$ 14,009

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The following table summarizes average recorded investment and interest income recognized on impaired loans by loan class for the three months ended March 31, 2016 and 2015.

	Three Months Ended March 31, 2016		**Three Months Ended March 31, 2015**	
(Amounts in thousands) **Average Recorded Investment and Interest Income**	**Average Recorded Investment**	**Interest Income Recognized**	**Average Recorded Investment**	**Interest Income Recognized**
Commercial	$2,215	$ 1	$5,363	$ 20
Commercial real estate:				
Real estate - commercial non-owner occupied	2,020	12	8,705	13
Real estate - commercial owner occupied	1,449	6	2,292	19
Residential real estate:				
Real estate - residential - ITIN	9,158	40	10,045	33
Real estate - residential - 1-4 family mortgage	1,753	—	1,988	—
Real estate - residential - equity lines	1,120	6	776	7
Consumer and other	32	—	35	—
Total	$17,747	$ 65	$29,204	$ 92

The impaired loans for which these interest income amounts were recognized primarily relate to accruing restructured loans. Loans are reported as troubled debt restructurings when we grant a concession(s) to a borrower experiencing financial difficulties that it would not otherwise consider. Examples of such concessions include a reduction in the loan rate, forgiveness of principal or accrued interest, extending the maturity date(s) significantly, or providing a lower interest rate than would be normally available for a transaction of similar risk. As a result of these concessions, restructured loans are impaired as we will not collect all amounts due, either principal or interest, in accordance with the terms of the original loan agreement.

At both March 31, 2016 and December 31, 2015, impaired loans of $6.9 million were classified as performing restructured loans. The restructurings were granted in response to borrower financial difficulty, and generally provide for a temporary modification of loan repayment terms.

In order for a restructured loan to be on accrual status, the loan's collateral coverage generally will be greater than or equal to 100% of the loan balance, the loan is current on payments, and the borrower must demonstrate the ability to make payments from a verified source of cash flow. We had no obligations to lend additional funds on the restructured loans as of March 31, 2016 and December 31, 2015.

As of March 31, 2016, we had $11.4 million in troubled debt restructurings compared to $15.9 million as of December 31, 2015. As of March 31, 2016, we had 119 loans that qualified as troubled debt restructurings, of which 108 loans were performing according to their restructured terms. Troubled debt restructurings represented 1.58% of gross loans as of March 31, 2016, compared to 2.22% at December 31, 2015.

The types of modifications offered can generally be described in the following categories:

Rate – A modification in which the interest rate is modified.

Maturity – A modification in which the maturity date, timing of payments or frequency of payments is modified.

Payment deferral – A modification in which a portion of the principal is deferred.

The following tables present the period ended balances of newly restructured loans and the types of modifications that occurred during the three months ended March 31, 2016 and 2015, respectively.

	For the Three Months Ended March 31, 2016		**For the Three Months Ended March 31, 2015**	
(Amounts in thousands)	**Payment**		**Payment**	
Troubled Debt Restructuring Modification Types	**Deferral**	**Total**	**Deferral**	**Total**
Commercial	$ —	$ —	$787	$787
Residential real estate:				
Real estate - residential - ITIN	—	—	274	274
Total	$ —	$ —	$1,061	$1,061

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The table below provides information regarding the number of loans where the contractual terms have been restructured in a manner, which grants a concession to a borrower experiencing financial difficulties for the three months ended March 31, 2016 and 2015.

(Amounts in thousands)	**For the Three Months Ended March 31, 2016**			**For the Three Months Ended March 31, 2015**		
Troubled Debt Restructurings	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Commercial	—	$ —	$ —	1	$ 823	$ 823
Residential real estate:						
Real estate - residential - ITIN	—	—	—	3	259	275
Total	—	$ —	$ —	4	$ 1,082	$ 1,098

The following table presents loans modified as troubled debt restructurings for which there was a payment default during the three months ended March 31, 2016 or during the three months ended March 31, 2015 on loans which were restructured within the 12 month periods preceding those dates.

(Amounts in thousands)	**For the Three Months Ended March 31, 2016**		**For the Three Months Ended March 31, 2015**	
Troubled Debt Restructurings That Subsequently Defaulted	**Number of Contracts**	**Recorded Investment**	**Number of Contracts**	**Recorded Investment**
Residential real estate:				
Real estate - residential - ITIN	—	$ —	1	$ 52
Total	—	$ —	1	$ 52

We define a performing loan as a loan where any installment of principal or interest is not 90 days or more past due, and management believes the ultimate collection of original contractual principal and interest is likely. We define a nonperforming loan as an impaired loan, which may be on nonaccrual, 90 days past due and still accruing, or has been restructured and is not in compliance with its modified terms, and our ultimate collection of original contractual principal and interest is uncertain. The foundation or primary factor in determining the appropriate credit quality indicators is the degree of a debtor's willingness and ability to perform as agreed.

Performing and nonperforming loans, segregated by class of loans, are as follows at March 31, 2016 and December 31, 2015.

(Amounts in thousands)	**March 31, 2016**		
Performing and Nonperforming Loans	**Performing**	**Nonperforming**	**Total**
Commercial	$134,158	$ 2,563	$136,721
Commercial real estate:			
Real estate - construction and land development	27,554	—	27,554
Real estate - commercial non-owner occupied	246,643	1,197	247,840
Real estate - commercial owner occupied	153,294	1,190	154,484
Residential real estate:			
Real estate - residential - ITIN	44,679	3,705	48,384
Real estate - residential - 1-4 family mortgage	9,205	1,742	10,947
Real estate - residential - equity lines	43,057	1,270	44,327
Consumer and other	53,955	31	53,986
Total	$712,545	$ 11,698	$724,243

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(Amounts in thousands)	**December 31, 2015**		
Performing and Nonperforming Loans	**Performing**	**Nonperforming**	**Total**
Commercial	$130,811	$ 1,994	$132,805
Commercial real estate:			
Real estate - construction and land development	28,319	—	28,319
Real estate - commercial non-owner occupied	237,886	5,488	243,374
Real estate - commercial owner occupied	155,228	1,071	156,299
Residential real estate:			
Real estate - residential - ITIN	45,457	3,649	49,106
Real estate - residential - 1-4 family mortgage	9,615	1,775	11,390
Real estate - residential - equity lines	45,473	—	45,473
Consumer and other	49,753	120	49,873
Total	$702,542	$ 14,097	$716,639

In conjunction with evaluating the performing versus nonperforming nature of our loan portfolio, management evaluates the following credit risk and other relevant factors in determining the appropriate credit quality indicator (rating) for each loan class:

Pass Grade: A Pass loan is a strong credit with no existing or known weaknesses that may require management's close attention. Some pass loans require short term enhanced monitoring to determine when the credit relationship would merit either an upgrade or a downgrade. Loans classified as Pass Grade specifically demonstrate:

- Strong Cash Flows – borrower's cash flows must meet or exceed our minimum debt service coverage ratio.
- Collateral Margin – generally, the borrower must have pledged an acceptable collateral class with an adequate collateral margin.
- Qualitative Factors – in addition to meeting our minimum cash flow and collateral requirements, a number of other qualitative factors are also factored into assigning a Pass Grade including the borrower's level of leverage (debt to equity), prospects, history and experience in their industry, credit history, and any other relevant factors including a borrower's character.

Those borrowers who qualify for unsecured loans must fully demonstrate above average cash flows and strong secondary sources of repayment to mitigate the lack of unpledged collateral.

Watch Grade: The credit is acceptable but the borrower has experienced a temporary setback or adverse information has been received, and may exhibit one or more of the characteristics shown in the list below. This risk grade could apply to credits on a temporary basis pending a full review. Credits with this risk grade will require more handling time and increased management. The list below contains characteristics of this risk grade, but individually do not automatically cause the loan to be assigned a Watch Grade.

The primary source of repayment may be weakening causing greater reliance on the secondary source of repayment or

The primary source of repayment is adequate, but the secondary source of repayment is insufficient

In-depth financial analysis would compare to the lower quartile in two or more of the major components of the Risk Management Association Annual Statement Studies

Volatile or deteriorating collateral

Management decisions may be called into question

Delinquencies in bank credits or other financial/trade creditors

Frequent overdrafts

Significant change in management/ownership

Special Mention Grade: Credits in this grade are potentially weak and deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects of the credit. Special Mention credits are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification. The list below exhibits the characteristics of this grade, but individually do not automatically cause the borrower to be assigned a grade of Special Mention:

Inadequate or incomplete loan documentation or perfection of collateral, or any other deviation from prudent lending practices

Credit is structured in a manner in which the timing of the repayment source does not match the payment schedule or maturity, materially jeopardizing repayment

Current economic or market conditions exist which may affect the borrower's ability to perform or affect the Bank's collateral position

Adverse trends in the borrower's operations or continued deterioration in the borrower’s financial condition that has not yet reached a point where the retirement of debt is jeopardized. A credit in this grade should have favorable prospects of the deteriorating financial trends reversing within a reasonable timeframe.

The borrower is less than cooperative or unable to produce current and adequate financial information

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Substandard Grade: A Substandard credit is inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Substandard credits have a well-defined weakness or weaknesses that jeopardize the liquidation or timely collection of the debt. Substandard credits are characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. However, a potential loss does not have to be recognizable in an individual credit for it to be considered a substandard credit. As such, substandard credits may or may not be graded as impaired.

The following represents, but is not limited to, the potential characteristics of a Substandard Grade and do not necessarily generate automatic reclassification into this loan grade:

- Sustained or substantial deteriorating financial trends,
- Unresolved management problems,
- Collateral is insufficient to repay debt; collateral is not sufficiently supported by independent sources, such as asset-based financial audits, appraisals, or equipment evaluations,
- Improper perfection of lien position, which is not readily correctable,
- Unanticipated and severe decline in market values,
- High reliance on secondary source of repayment,
- Legal proceedings, such as bankruptcy or a divorce, which has substantially decreased the borrower’s capacity to repay the debt,
- Fraud committed by the borrower,
- IRS liens that take precedence,
- Forfeiture statutes for assets involved in criminal activities,
- Protracted repayment terms outside of policy that are for longer than the same type of credit in our portfolio,
- Any other relevant quantitative or qualitative factor that negatively affects the current net worth and paying capacity of the borrower or of the collateral pledged, if any.

Doubtful Grade: A Doubtful loan 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 pending factors that may work to the advantage and strengthening of the credit, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors may include, but are not limited to:

- Proposed merger(s),

Acquisition or liquidation procedures,
Capital injection,
Perfecting liens on additional collateral,
Refinancing plans.

Generally, a Doubtful Grade does not remain outstanding for a period greater than six months. After six months, the pending events should have either occurred or not occurred. The credit grade should have improved or the principal balance charged against the ALLL.

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The following tables summarize internal risk rating by loan class as of March 31, 2016, and December 31, 2015.

	As of March 31, 2016					
(Amounts in thousands)	**Pass**	**Watch**	**Special Mention**	**Substandard**	**Doubtful**	**Total**
Commercial	$110,209	$13,595	$10,092	$ 2,825	$ —	$136,721
Commercial real estate:						
Real estate - construction and land development	27,136	418	—	—	—	27,554
Real estate - commercial non-owner occupied	242,940	936	952	3,012	—	247,840
Real estate - commercial owner occupied	146,093	5,636	1,219	1,536	—	154,484
Residential real estate:						
Real estate - residential - ITIN	40,638	—	—	7,746	—	48,384
Real estate - residential - 1-4 family mortgage	8,630	—	575	1,742	—	10,947
Real estate - residential - equity lines	40,405	1,733	—	2,189	—	44,327
Consumer and other	53,673	5	244	64	—	53,986
Total	$669,724	$22,323	$13,082	$ 19,114	$ —	$724,243

	As of December 31, 2015					
(Amounts in thousands)	**Pass**	**Watch**	**Special Mention**	**Substandard**	**Doubtful**	**Total**
Commercial	$108,696	$10,240	$9,587	$ 4,282	$ —	$132,805
Commercial real estate:						
Real estate - construction and land development	28,291	28	—	—	—	28,319
Real estate - commercial non-owner occupied	234,177	917	1,588	6,692	—	243,374
Real estate - commercial owner occupied	149,327	3,864	1,687	1,421	—	156,299
Residential real estate:						
Real estate - residential - ITIN	41,480	—	—	7,626	—	49,106
Real estate - residential - 1-4 family mortgage	9,041	—	575	1,774	—	11,390
Real estate - residential - equity lines	41,149	1,760	1,682	882	—	45,473
Consumer and other	49,551	—	256	66	—	49,873
Total	$661,712	$16,809	$15,375	$ 22,743	$ —	$716,639

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The following tables summarize the ALLL by portfolio for the three months ended March 31, 2016 and 2015.

(Amounts in thousands)	**For the Three Months Ended March 31, 2016**					
ALLL by Portfolio	**Commercial**	**Commercial Real Estate**	**Residential Real Estate**	**Consumer**	**Unallocated**	**Total**
Beginning balance	$2,493	$ 5,784	$ 1,577	$ 770	$ 556	$11,180
Charge offs	(85)	(6)	(73)	(143)	—	(307)
Recoveries	32	528	8	54	—	622
Provision	26	(414)	449	133	(194)	—
Ending balance	$2,466	$ 5,892	$ 1,961	$ 814	$ 362	$11,495

(Amounts in thousands)	**For the Three Months Ended March 31, 2015**					
ALLL by Portfolio	**Commercial**	**Commercial Real Estate**	**Residential Real Estate**	**Consumer**	**Unallocated**	**Total**
Beginning balance	$3,503	$ 4,875	$ 1,670	$ 450	$ 322	$10,820
Charge offs	(52)	—	(15)	(112)	—	(179)
Recoveries	26	594	35	—	—	655
Provision	(232)	(155)	29	234	124	—
Ending balance	$3,245	$ 5,314	$ 1,719	$ 572	$ 446	$11,296

The following tables summarize the ALLL and the recorded investment in loans and leases as of March 31, 2016 and December 31, 2015.

	As of March 31, 2016					
(Amounts in thousands)	**Commercial**	**Commercial Real Estate**	**Residential Real Estate**	**Consumer**	**Unallocated**	**Total**
ALLL:						
Individually evaluated for impairment	$124	$ 94	$ 838	$ 12	$ —	$1,068
Collectively evaluated for impairment	2,342	5,798	1,123	802	362	10,427

Total	$2,466	$ 5,892	$ 1,961	$ 814	$ 362	$11,495
Gross loans:						
Individually evaluated for impairment	$2,603	$ 3,555	$ 12,913	$ 31	$ —	$19,102
Collectively evaluated for impairment	134,118	426,323	90,745	53,955	—	705,141
Total gross loans	$136,721	$ 429,878	$ 103,658	$ 53,986	$ —	$724,243

	As of December 31, 2015					
(Amounts in thousands)	**Commercial**	**Commercial Real Estate**	**Residential Real Estate**	**Consumer**	**Unallocated**	**Total**
ALLL:						
Individually evaluated for impairment	$122	$ 97	$ 600	$ 13	$ —	$832
Collectively evaluated for impairment	2,371	5,687	977	757	556	10,348
Total	$2,493	$ 5,784	$ 1,577	$ 770	$ 556	$11,180
Gross loans:						
Individually evaluated for impairment	$2,043	$ 7,733	$ 11,582	$ 32	$ —	$21,390
Collectively evaluated for impairment	130,762	420,259	94,387	49,841	—	695,249
Total gross loans	$132,805	$ 427,992	$ 105,969	$ 49,873	$ —	$716,639

The ALLL totaled $11.5 million or 1.59% of total gross loans at March 31, 2016 and $11.2 million or 1.56% at December 31, 2015. As of March 31, 2016, we had $203.0 million in commitments to extend credit, and recorded a reserve for unfunded commitments of $695 thousand in *Other Liabilities* in the *Consolidated Balance Sheets*.

The ALLL is based upon estimates of loan and lease losses and is maintained at a level considered adequate to provide for probable losses inherent in the outstanding loan portfolio. Our ALLL methodology significantly incorporates management’s current judgments, and reflects the reserve amount that is necessary for estimated loan and lease losses and risks inherent in the loan portfolio in accordance with ASC Topic 450 *Contingencies* and ASC Topic 310 *Receivables.*

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The allowance is increased by provisions charged to expense and reduced by net charge offs. In periodic evaluations of the adequacy of the allowance balance, management considers past loan and lease loss experience by type of credit, known and inherent risks in the portfolio, adverse situations that may affect a borrower's ability to repay, the estimated value of any underlying collateral, current economic conditions and other factors. We formally assess the adequacy of the ALLL on a monthly basis. These assessments include the periodic re-grading of classified loans based on changes in their individual credit characteristics including delinquency, seasoning, recent financial performance of the borrower, economic factors, changes in the interest rate environment and other factors as warranted. Loans are initially rated when originated. They are reviewed as they are renewed, when there is a new loan to the same borrower and/or when identified facts demonstrate heightened risk of default. Confirmation of the quality of our grading process is obtained by independent reviews conducted by outside consultants specifically hired for this purpose and by periodic examination by various bank regulatory agencies.

Management monitors delinquent loans continuously and identifies problem loans to be evaluated individually for impairment testing. For loans that are determined impaired, a formal impairment measurement is performed at least quarterly on a loan-by-loan basis.

Our method for assessing the appropriateness of the allowance includes specific allowances for identified problem loans, an allowance factor for categories of credits and allowances for changing environmental factors (e.g., portfolio trends, concentration of credit, growth, economic factors). Allowances for identified problem loans are based on specific analysis of individual credits. Loss estimation factors for loan categories are based on analysis of local economic factors applicable to each loan category. Allowances for changing environmental factors are management's best estimate of the probable impact these changes have had on the loan portfolio as a whole.

We believe that the ALLL was adequate as of March 31, 2016. There is, however, no assurance that future loan and lease losses will not exceed the levels provided for in the ALLL and could possibly result in additional charges to the provision for loan and lease losses. In addition, bank regulatory authorities, as part of their periodic examination of the Company, may require additional charges to the provision for loan and lease losses in future periods if warranted as a result of their review.

As of March 31, 2016, approximately 74% of our gross loan portfolio is secured by real estate, and a significant decline in real estate market values may require an increase in the ALLL. The U.S. recession, the housing market downturn, and low real estate values in our markets have negatively impacted aspects of our residential development, commercial real estate, commercial construction and commercial loan portfolios. Deterioration in our markets may adversely affect our loan portfolio and may lead to additional charges to the provision for loan and lease losses.

All impaired loans are individually evaluated for impairment. If the measurement of each impaired loans' value is less than the recorded investment in the loan, we recognize this impairment and adjust the carrying value of the loan to fair value through the ALLL. For collateral dependent loans, this can be accomplished by charging off the impaired portion of the loan based on the underlying value of the collateral. For non-collateral dependent loans, we establish a specific component within the ALLL based on the present value of the future cash flows. If we determine the sources of repayment will not result in a reasonable probability that the carrying value of a loan can be recovered, the amount of a loan's specific impairment is charged off against the ALLL. Impairment reserves on non-collateral dependent restructured loans are measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan's carrying value. These impairment reserves are recognized as a specific component to be provided for in the ALLL.

The unallocated portion of ALLL provides for coverage of credit losses inherent in the loan portfolio but not captured in the credit loss factors that are utilized in the risk rating-based component, or in the specific impairment reserve component of the ALLL, and acknowledges the inherent imprecision of all loss prediction models. As of March 31, 2016, the unallocated allowance amount represented 3% of the ALLL, compared to 5% at December 31, 2015. The ALLL composition should not be interpreted as an indication of specific amounts or loan categories in which future charge offs may occur.

We have lending policies and procedures in place with the objective of optimizing loan income within an accepted risk tolerance level. We review and approve these policies and procedures annually. Monitoring and reporting systems supplement the review process with regular frequency as related to loan production, loan quality, concentrations of credit, potential problem loans, loan delinquencies, and nonperforming loans.

The following is a brief summary, by loan type, of management's evaluation of the general risk characteristics and underwriting standards:

Commercial Loans – Commercial loans are underwritten after evaluating the borrower's financial ability to maintain profitability including future expansion objectives. In addition, the borrower's qualitative qualities are evaluated, such as management skills and experience, ethical traits, and overall business acumen. Commercial loans are primarily extended based on the cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The borrower's cash flow may deviate from initial projections, and the value of collateral securing these loans may vary.

Most commercial loans are generally secured by the assets being financed and other business assets such as accounts receivable or inventory. Management may also incorporate a personal guarantee; however, some short term loans may be extended on an unsecured basis. Repayment of commercial loans secured by accounts receivable may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

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Commercial Real Estate (“CRE”) Loans – CRE loans are subject to similar underwriting standards and processes as commercial loans. CRE loans are viewed predominantly as cash flow loans and secondarily as loans collateralized by real estate. Generally, CRE lending involves larger principal amounts with repayment largely dependent on the successful operation of the property securing the loan or the business conducted on the collateralized property. CRE loans tend to be more adversely affected by conditions in the real estate markets or by general economic conditions.

The properties securing the CRE portfolio are diverse in terms of type and primary source of repayment. This diversity helps reduce our exposure to adverse economic events that affect any single industry. We monitor and evaluate CRE loans based on occupancy status (investor versus owner occupied), collateral, geography, and risk grade criteria.

Generally, CRE loans to developers and builders that are secured by non-owner occupied properties require the borrower to have had an existing relationship with the Company and a proven record of success. Construction loans are underwritten utilizing feasibility studies, sensitivity analysis of absorption and lease rates, and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of cost and value associated with the complete project (as-is value). These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment largely 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 secured. These loans are closely monitored by on-site inspections, and are considered to have higher inherent risks than other CRE loans due to their ultimate repayment sensitivity to interest rate changes, governmental regulation of real property, general economic conditions, and the availability of long term financing.

Consumer Loans – Our consumer loan originations are generally limited to home equity loans with nominal originations in unsecured personal loans. The portfolio also includes unsecured consumer home improvement loans with an ongoing purchase commitment and residential solar panel loans secured by UCC filing purchased during 2014 We are highly dependent on third party credit scoring analysis to supplement the internal underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by management 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 are heavily influenced by statutory requirements, which include, but are not limited to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time, and documentation requirements.

We maintain an independent loan review program that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to the Board of Directors and Audit Committee. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as our policies and procedures.

Management's continuing evaluation of all known relevant quantitative and qualitative internal and external risk factors provide the foundation for the three major components of the ALLL: (1) historical valuation allowances established in accordance with ASC 450, Contingencies ("ASC 450") for groups of similarly situated loan pools; (2) general valuation allowances established in accordance with ASC 450 and based on qualitative credit risk factors; and (3) specific valuation allowances established in accordance with ASC 310, Receivables ("ASC 310") and based on estimated probable losses on specific impaired loans. All three components are aggregated and constitute the ALLL; while portions of the allowance may be allocated to specific credits, the allowance net of specific reserves is available for the remaining credits that management deems as "loss." It is our policy to classify a credit as loss with a concurrent charge off when management considers the credit uncollectible and of such little value that its continuance as a bankable asset is not warranted. A loss classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer recognizing the likely credit loss of a valueless asset even though partial recovery may occur in the future.

In accordance with ASC 450, historical valuation allowances are established for loan pools with similar risk characteristics common to each loan grouping. Our loan portfolio is evaluated by general loan class including commercial, commercial real estate (which includes construction and other real estate), residential real estate (which includes 1-4 family and home equity loans), consumer and other loans.

These loan pools are similarly risk-graded and each portfolio is evaluated by identifying all relevant risk characteristics that are common to these segmented groups of loans. These characteristics include a significant emphasis on historical losses within each loan group, inherent risks for each, and specific loan class characteristics such as trends related to nonaccrual loans, past due loans, criticized loans, net charge offs or recoveries, among other relevant credit risk factors. We periodically review and update our historical loss ratios based on net charge off experience for each loan and lease class. Other credit risk factors are also reviewed periodically and adjusted as necessary to account for any changes in potential loss exposure.

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General valuation allowances, as prescribed by ASC 450, are based on qualitative factors such as changes in asset quality trends, concentrations of credit or changes in concentrations of credit, changes in underwriting standards, changes in experience or depth of lending staff or management, the effectiveness of loan grading and the internal loan review function, and any other relevant factors. Management evaluates each qualitative component quarterly to determine the associated risks to the quality of our loan portfolio.

NOTE 6. OTHER REAL ESTATE OWNED

At March 31, 2016, and December 31, 2015, the recorded investment in OREO was $1.0 million and $1.4 million, respectively. For the three months ended March 31, 2016, there were no foreclosed properties transferred into OREO. During the three months ended March 31, 2016, we sold five properties with a balance of $358 thousand for a net loss of $125 thousand. During the quarter ended March 31, 2016, we recognized a write-down in OREO for three properties totaling $55 thousand. The March 31, 2016 OREO balance consists of three 1-4 family residential real estate properties in the amount of $306 thousand, two nonfarm nonresidential properties in the amount of $557 thousand and one undeveloped commercial property in the amount of $147 thousand. The recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure is $1.1 million.

NOTE 7. INTANGIBLES

In March of 2016, as part of our branch acquisition, we recorded a core deposit intangible of $1.8 million and goodwill of $717 thousand. The new core deposit base provides value as a source of below market rate funds and the realization of cost savings is a fundamental rationale for assuming these deposit liabilities. The cost savings is defined as the difference between the cost of funds on our new deposits (i.e., interest and net maintenance costs) and the cost of an equal amount of funds from an alternative source having a similar term as the new deposit base. Our core deposit intangible is recorded at fair value which was derived by using the income approach and represents the present value of the cost savings over the projected term of our new deposit base.

The core deposit intangible is being amortized on a straight-line basis over the estimated useful life of the deposits, which is eight years, with no expected residual value. For tax purposes, the core deposit intangible is expected to be treated as a taxable asset, resulting in amortizable tax basis of $1.8 million.

As of March 31, 2016, we have recorded the following amounts related to the core deposit intangible.

(Amounts in thousands) **Intangibles**	**March 31, 2016**
Gross carrying amount	$ 1,772
Accumulated amortization	(20)
Core deposit intangibles, net	$ 1,752

The following table sets forth, as of March 31, 2016, the total estimated amortization of intangible assets:

(Amounts in thousands) **For the year ended December 31,**	**Amount**
2016	$ 166
2017	221
2018	221
2019	221
2020	221
2021	221
2022 and thereafter	481
Total	$ 1,752

Goodwill is calculated as the amount of cash paid in excess of the fair value of the net assets acquired in the transaction. Goodwill is not amortized, but is annually reviewed for impairment. See Note *17 Branch Acquisition* in the *Notes to Consolidated Financial Statements* in this document for further detail on the branch acquisition.

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NOTE 8. ACCOUNTING FOR INCOME TAXES AND UNCERTAINTIES

Our provision for income taxes includes both federal and state income taxes and reflects the application of federal and state statutory rates to the Company's income before taxes. The principal difference between statutory tax rates and our effective tax rate is the benefit derived from investing in tax-exempt securities, federal tax credits afforded through our investments in qualified partnerships and bank-owned life insurance.

Income taxes are accounted for using the asset and liability method. Under this method, a deferred tax asset or liability is determined based on the enacted tax rates, which will be in effect when the differences between the financial statement carrying amounts and tax basis of existing assets and liabilities are expected to be reported in our income tax returns. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established to reduce the net carrying amount of deferred tax assets if it is determined to be more likely than not, that all or some portion of the potential deferred tax asset will not be realized.

We apply the provisions of FASB ASC 740, *Income Taxes*, relating to the accounting for uncertainty in income taxes. We periodically review our income tax positions based on tax laws and regulations, and financial reporting considerations, and record adjustments as appropriate. This review takes into consideration the status of current taxing authorities' examinations of our tax returns, recent positions taken by the taxing authorities on similar transactions, if any, and the overall tax environment. Our uncertain tax positions were nominal in amount as of March 31, 2016.

NOTE 9. QUALIFIED AFFORDABLE HOUSING PARTNERSHIP INVESTMENTS

Our investment in Qualified Affordable Housing Partnerships that generate Low Income Housing Tax Credits ("LIHTC") and deductible operating losses was $4.6 million at March 31, 2016. These investments are recorded in other assets with a corresponding funding obligation of $1.0 million recorded in *Other Liabilities* in our *Consolidated Balance Sheets*. We have invested in four separate LIHTC partnerships, which provide the Company with CRA credit. Additionally, the investments in LIHTC partnerships provide us with tax credits and with operating loss tax benefits over an approximately 18 year period. None of the original investments will be repaid. The tax credits and the operating loss tax benefits that are generated by each of the properties are expected to exceed the total value of the investments we made and provide returns on the investments of between 4% and 7%. The investments in LIHTC partnerships are being accounted for using the proportional amortization method, under which we amortize the initial cost of an investment in proportion to the amount of the tax credits and other tax benefits received, and recognize the net investment performance in the *Consolidated Statements of Operations* as a component of income tax expense.

The following table presents our original investment in LIHTC partnerships, the current recorded investment balance, and the unfunded liability balance of each investment at March 31, 2016 and December 31, 2015. In addition, the table reflects the tax credits and tax benefits, amortization of the investment and the net impact to our income tax provision for the three months ended March 31, 2016 and the year ended December 31, 2015.

(Amounts in thousands)	**Original**	**Current**	**Unfunded**	**Tax Credits**	**Amortization**	**Net**
Qualified Affordable Housing Partnerships at	**Investment**	**Recorded**	**Liability**	**and**	**of**	**Income Tax**
March 31, 2016	**Value**	**Investment**	**Obligation**	**Benefits (1)**	**Investments (2)**	**Benefit**
Raymond James California Housing Opportunities Fund II	$ 2,000	$ 1,508	$ 235	$ 56	$ 45	$ 11
WNC Institutional Tax Credit Fund 38, L.P.	1,000	771	159	35	26	9
Merritt Community Capital Corporation Fund XV, L.P.	2,500	1,762	610	69	57	12
California Affordable Housing Fund	2,454	593	—	52	52	—
Total - investments in qualified affordable housing partnerships	$ 7,954	$ 4,634	$ 1,004	$ 212	$ 180	$ 32

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(Amounts in thousands) Qualified Affordable Housing Partnerships at December 31, 2015	Original Investment Value	Current Recorded Investment	Unfunded Liability Obligation	Tax Credits and Benefits (1)	Amortization of Investments (2)	Net Income Tax Benefit
Raymond James California Housing Opportunities Fund II	$ 2,000	$ 1,553	$ 406	$ 226	$ 184	$ 42
WNC Institutional Tax Credit Fund 38, L.P.	1,000	797	166	126	93	33
Merritt Community Capital Corporation Fund XV, L.P.	2,500	1,820	610	278	230	48
California Affordable Housing Fund	2,454	645	—	207	207	—
Total - investments in qualified affordable housing partnerships	$ 7,954	$ 4,815	$ 1,182	$ 837	$ 714	$ 123

(1) The amounts reflected in this column represent both the tax credits, and estimated tax benefits generated by the Qualified Affordable Housing partnerships operating loss for the year.

(2) This amount reduces the tax credits and benefits generated by the Qualified Affordable Housing partnerships.

The following table presents our generated tax credits and tax benefits from investments in qualified affordable housing partnerships for the three months ended March 31, 2016 and 2015.

(Amounts in thousands)	For the Three Months Ended			
	March 31, 2016		March 31, 2015	
Qualified Affordable Housing Partnerships	**Generated Tax Credits**	**Tax Benefits From Taxable Losses**	**Generated Tax Credits**	**Tax Benefits from Taxable Losses**
Raymond James California Housing Opportunities Fund II	$44	$ 12	$43	$ 13
WNC Institutional Tax Credit Fund 38, L.P.	28	7	25	7
Merritt Community Capital Corporation Fund XV, L.P.	55	14	54	15
California Affordable Housing Fund	40	12	40	12
Total	$167	$ 45	$162	$ 47

The tax credits and benefits were partially offset by the amortization of the principal investment balances of $180 thousand and $178 thousand for the three months ended March 31, 2016 and March 31, 2015, respectively.

The following table reflects the anticipated net income tax benefit at March 31, 2016 that is expected to be recognized over the remaining life of the investments.

(Amounts in thousands) **Qualified Affordable Housing Partnerships**	**Raymond James California Housing Opportunities Fund II**	**WNC Institutional Tax Credit Fund 38, L.P.**	**Merritt Community Capital Corporation Fund XV, L.P**	**California Affordable Housing Fund**	**Total Net Income Tax Benefit**
Anticipated net income tax benefit less amortization of investments:					
2016	$ 35	$ 27	$ 35	$ —	$97
2017	46	35	45	1	127
2018	45	34	45	—	124
2019	45	30	44	—	119
2020 and thereafter	218	128	194	1	541
Total	$ 389	$ 254	$ 363	$ 2	$1,008

NOTE 10. FEDERAL FUNDS PURCHASED AND LINES OF CREDIT

At March 31, 2016 and December 31, 2015, we had no outstanding federal funds purchased balances. At March 31, 2016 and December 31, 2015, we had outstanding borrowings with the Federal Home Loan Bank of San Francisco of $- 0 - and $75.0 million, respectively. At March 31, 2016, the Bank had available lines of credit with the Federal Home Loan Bank of San Francisco totaling $297.7 million and with the Federal Reserve Bank totaling $17.5 million. These lines of credit are subject to maintenance of required capital ratios and minimum collateral requirements, namely the amount of pledged loans and securities.

The Bank had nonbinding federal funds line of credit agreements with three financial institutions totaling $40.0 million at March 31, 2016. The lines of credit had interest rates ranging from 0.53% to 1.38% at March 31, 2016. Availability of the lines is subject to federal funds balances available for loan, continued borrower eligibility and are reviewed and renewed periodically throughout the year. These lines are intended to support short-term liquidity needs, and the agreements may restrict consecutive day usage.

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NOTE 11. TERM DEBT

Term debt at March 31, 2016 and December 31, 2015 consisted of the following.

(Amounts in thousands)	**March 31, 2016**	**December 31, 2015**
Federal Home Loan Bank of San Francisco borrowings	$—	$ 75,000
Senior debt	9,667	9,917
Unamortized debt issuance costs	(14)	(15)
Subordinated debt	10,000	10,000
Unamortized debt issuance costs	(199)	(208)
Corning lease	172	—
Net term debt	$19,626	$ 94,694

Future contractual maturities of term debt at March 31, 2016 are as follows.

(Amounts in thousands)	**2016**	**2017**	**2018**	**2019**	**2020**	**Thereafter**	**Total**
Senior debt	$667	$1,000	$1,000	$1,000	$1,000	$ 5,000	$9,667
Subordinated debt	—	—	—	—	—	10,000	10,000
Corning lease	32	41	44	46	9	—	172
Total future maturities	$699	$1,041	$1,044	$1,046	$1,009	$ 15,000	$19,839

Federal Home Loan Bank of San Francisco Borrowings

The maximum amount outstanding from the Federal Home Loan Bank of San Francisco under term advances at any month end during the three months ended March 31, 2016 and the year ended December 31, 2015 was $80.0 million and $120.0 million, respectively. The average balance outstanding on Federal Home Loan Bank of San Francisco term advances during the three months ended March 31, 2016 and the year ended December 31, 2015 was $71.8 million and $87.6 million, respectively. During the three months ended March 31, 2016, all outstanding Federal Home Loan Bank of San Francisco term advances were repaid. The weighted average interest rates on the borrowings outstanding at December 31, 2015, was 0.33%.

The Federal Home Loan Bank of San Francisco line of credit is secured by an investment in Federal Home Loan Bank of San Francisco stock, certain real estate mortgage loans which have been specifically pledged to the Federal Home Loan Bank of San Francisco pursuant to their collateral requirements, and securities held in the Bank's investment securities portfolio. As of March 31, 2016, the Bank was required to hold an investment in Federal Home Loan Bank of San Francisco stock of $4.5 million. Furthermore, we have pledged $349.6 million of our commercial and real estate mortgage loans for the line of credit with the Federal Home Loan Bank of San Francisco. As of March 31, 2016, we held $19.0 million in securities with the Federal Home Loan Bank of San Francisco for pledging purposes. All of the securities pledged to the Federal Home Loan Bank of San Francisco were unused as collateral as of March 31, 2016.

Senior Debt

In December of 2015, the Holding Company, entered into a senior debt loan agreement to borrow $10.0 million from another financial institution. The loan is payable in monthly installments of $83 thousand principal, plus accrued and unpaid interest, commencing on January 1, 2016 and continuing to and including December 10, 2020. The loan may be prepaid in whole or in part at any time without any prepayment premium or penalty. The principal amount of the loan bears interest at a variable rate, resetting monthly that is equal to the sum of the current three month LIBOR plus 400 basis points. In December of 2015, the Holding Company incurred senior debt issuance costs of $15 thousand, which are being amortized over the life of the loan as additional interest expense. The loan is secured by a pledge from the Holding Company of all of the outstanding stock of Redding Bank of Commerce.

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Subordinated Debt

In December of 2015, the Holding Company issued $10.0 million in aggregate principal amount of fixed to floating rate subordinated notes due in 2025. The subordinated debt initially bears interest at 6.88% per annum for a five-year term, payable semi-annually. Thereafter, interest on the subordinated debt will be paid at a variable rate equal to three month LIBOR plus 526 basis points, payable quarterly until the maturity date. In December of 2015, the Holding Company incurred subordinated debt issuance costs of $210 thousand, which are being amortized over the initial five year term as additional interest expense.

The subordinated debt is subordinate and junior in right of payment to the prior payment in full of all existing and future claims of creditors and depositors of the Holding Company and its subsidiaries, whether now outstanding or subsequently created. The subordinated debt ranks equally with all other unsecured subordinated debt, except any which by its terms is expressly stated to be subordinated to the subordinated debt. The subordinated debt ranks senior to all future junior subordinated debt obligations, preferred stock and common stock of the Holding Company. The subordinated debt is recorded as term debt on the Holding Company’s Balance Sheet; however, for regulatory purposes, it is treated as Tier 2 capital by the Holding Company.

The subordinated debt will mature on December 10, 2025 but may be prepaid at the Holding Company’s option and with regulatory approval at any time on or after five years after the Closing Date or at any time upon certain events, such as a change in the regulatory capital treatment of the subordinated debt or the interest on the subordinated debt is no longer deductible by the Holding Company for United States federal income tax purposes.

Corning Lease

As part of the acquisition of branches from Bank of America, the Bank entered into a capital lease with Bank of America for the branch located in Corning, California. The total obligation under the lease agreement is $172 thousand payable over a four-year period in monthly installments of principal and interest at a 6.0% annual interest rate. The fair value of the capital lease obligation was determined using a discounted cash flow based on the contractual interest rate of the lease agreement. The fair value of the leased asset is included in premises and equipment and the lease liability is included with term debt obligations. Amortization of the leased asset is included with the provision for depreciation and amortization as part of our premises and equipment expense in our

Consolidated Statements of Operations. The lease may terminate early upon receipt of certification that there are no adverse environmental conditions. Upon termination of the lease agreement, the net present value of the lease becomes due and title will be transferred to the Bank.

NOTE 12. COMMITMENTS AND CONTINGENCIES

Lease Commitments – We lease seven sites under non-cancelable operating leases. The leases contain various provisions for increases in rental rates, based on predetermined escalation schedules. Substantially all of the leases include the option to extend the lease term one or more times following expiration of the initial term.

The following table sets forth rent expense and rent income for the three months ended March 31, 2016 and 2015.

	Three Months Ended March 31,	
(Amounts in thousands)	**2016**	**2015**
Rent income	$10	$4
Rent expense	145	142
Net rent expense	$135	$138

The following table sets forth, as of March 31, 2016, the future minimum lease payments under non-cancelable operating leases.

(Amounts in thousands)	
Amounts due in:	
2016	$483
2017	584
2018	467
2019	438
2020	449
Thereafter	1,345
Total	$3,766

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Financial Instruments with Off-Balance Sheet Risk

Our consolidated financial statements do not reflect various commitments and contingent liabilities that arise in the normal course of our business and involve elements of credit, liquidity, and interest rate risk.

The following table presents a summary of our commitments and contingent liabilities at March 31, 2016 and December 31, 2015.

(Amounts in thousands)	**March 31, 2016**	**December 31, 2015**
Commitments to extend credit	$197,605	$224,757
Standby letters of credit	2,098	2,477
Affordable Housing Grant Sponsorship	3,344	3,356
Total commitments	$203,047	$230,590

In the normal course of business, we are party to financial instruments with off-balance sheet credit risk to meet the financing needs of our customers. These financial instruments include commitments to extend credit, standby letters of credit and financial guarantees. These instruments involve elements of credit and interest rate risk similar to the amounts recognized in the *Consolidated Balance Sheets*. The contract or notional amounts of these instruments reflect the extent of our involvement in particular classes of financial instruments.

Our exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, standby letters of credit, and financial guarantees, is represented by the contractual notional amount of those instruments. We use the same credit policies in making commitments and conditional obligations as we use for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any covenant or condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

While most standby letters of credit are not utilized, a significant portion of such utilization is on an immediate payment basis. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Bank upon extension of credit, is based on our credit evaluation of the counterparty. Collateral varies but may include cash, accounts receivable, inventory, premises and equipment and income-producing commercial properties.

Standby letters of credit and financial guarantees are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements, including international trade finance, commercial paper, bond financing and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

We hold cash, marketable securities, or real estate as collateral supporting those commitments for which collateral is deemed necessary. We were not required to perform on any financial guarantees for the three months ended March 31, 2016, and the year ended December 31, 2015. At March 31, 2016, approximately $133 thousand of standby letters of credit expire within one year, and $2.0 million expire thereafter.

The reserve for unfunded commitments, which is included in *Other Liabilities* on the *Consolidated Balance Sheets*, was $695 thousand at March 31, 2016 and $695 thousand at December 31, 2015. The adequacy of the reserve for unfunded commitments is reviewed on a quarterly basis, based upon changes in the amount of commitments, loss experience, and economic conditions. During the three months ended March 31, 2016, we made no additional provision to the reserve for unfunded commitments. When necessary, the provision expense is recorded in other noninterest expense in the *Consolidated Statements of Operations.*

Legal Proceedings – We are involved in various pending and threatened legal actions arising in the ordinary course of business. We maintain reserves for losses from legal actions, which are both probable and estimable. In our opinion, the disposition of claims currently pending will not have a material adverse effect on our financial position or results of operations.

Concentrations of Credit Risk – We grant real estate construction, commercial, and installment loans to customers throughout northern California. In our judgment, a concentration exists in real estate related loans, which represented approximately 74% of our gross loan portfolio at March 31, 2016 and December 31, 2015.

Commercial real estate concentrations are managed to assure wide geographic and business diversity. Although management believes such concentrations have no more than the normal risk of collectability, a substantial decline in the economy in general, material increases in interest rates, changes in tax policies, tightening credit or refinancing markets, or a decline in real estate values in our principal market areas in particular, could have an adverse impact on the repayment of these loans. Personal and business incomes, proceeds from the sale of real property, or proceeds from refinancing, represent the primary sources of repayment for a majority of these loans.

We recognize the credit risks inherent in dealing with other depository institutions. Accordingly, to prevent excessive exposure to other depository institutions in aggregate or to any single correspondent, we have established general standards for selecting correspondent banks as well as internal limits for allowable exposure to other depository institutions in aggregate or to any single correspondent. In addition, we have an investment policy that sets forth limitations that apply to all investments with respect to credit rating and concentrations with an issuer.

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Notes to Consolidated Financial Statements (Unaudited)

NOTE 13. ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table presents activity in accumulated other comprehensive income for the three months ended March 31, 2016.

(Amounts in thousands)	**Unrealized Gains on Securities**	**Unrealized (Losses) Gains on Derivatives**	**Accumulated Other Comprehensive (Loss) Income**
Accumulated other comprehensive loss as of December 31, 2015	$ 1,142	$ (1,396)	$ (254)
Comprehensive income three months ended March 31, 2016	50	1,396	1,446
Accumulated other comprehensive income as of March 31, 2016	$ 1,192	$ —	$ 1,192

The following table presents activity in accumulated other comprehensive income for the three months ended March 31, 2015.

(Amounts in thousands)	**Unrealized Gains on Securities**	**Unrealized Losses on Derivatives**	**Accumulated Other Comprehensive (Loss) Income**
Accumulated other comprehensive loss as of December 31, 2014	$ 1,810	$ (1,897)	$ (87)
Comprehensive income three months ended March 31, 2015	292	(21)	271
Accumulated other comprehensive income as of March 31, 2015	$ 2,102	$ (1,918)	$ 184

Accumulated other comprehensive income is reported net of related tax effects. Detailed information on the tax effects of the individual components of comprehensive income are presented in the *Consolidated Statements of Comprehensive Income*.

NOTE 14. DERIVATIVES

We use derivatives to hedge the risk of changes in market interest rates to limit the impact on earnings and cash flows relating to specific groups of assets and liabilities. During 2015 and the first quarter of 2016 we utilized interest rate swaps (the "hedging instrument") with other major financial institutions (counterparties) to hedge interest expenses associated with certain Federal Home Loan Bank of San Francisco borrowings (the "hedged instrument"). We do not use derivative instruments for trading or speculative purposes.

For derivative financial instruments accounted for as hedging instruments, we formally designate and document, at inception, the financial instrument as a hedge of a specific underlying exposure, the risk management objective, and the manner in which the effectiveness of the hedge will be assessed. We formally assess both at inception and at each reporting period thereafter, whether the derivative financial instruments used in hedging transactions are effective in offsetting changes in cash flows of the related underlying exposures. Any ineffective portion of the changes in cash flow of the instruments is recognized immediately into earnings.

ASC 815-10, *Derivatives and Hedging* ("ASC 815") requires companies to recognize all derivative instruments as assets or liabilities at fair value in the *Consolidated Balance Sheets*. In accordance with ASC 815, we designated our interest rate swaps as cash flow hedges of certain active and forecasted variable rate Federal Home Loan Bank of San Francisco advances. Changes in the fair value of the hedging instrument, except any ineffective portion, are recorded in accumulated other comprehensive income until earnings are impacted by the hedged instrument. No components of our hedging instruments are excluded from the assessment of hedge effectiveness in hedging exposure to variability in cash flows.

Classification of the gain or loss in the *Consolidated Statements of Operations* upon release from accumulated other comprehensive income is the same as that of the underlying exposure. We discontinue the use of hedge accounting prospectively when (1) the derivative instrument is no longer effective in offsetting changes in fair value or cash flows of the underlying hedged item; (2) the derivative instrument expires, is sold, terminated, or exercised; or (3) designating the derivative instrument as a hedge is no longer appropriate. When we discontinue hedge accounting because it is no longer probable that an anticipated transaction will occur in the originally expected period, or within an additional two-month period thereafter, changes to fair value that were recorded in accumulated other comprehensive income are recognized immediately in earnings.

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At December 31, 2015, we had one active interest rate swap, and one forward starting interest rate swap to hedge interest rate risk associated with current and forecasted variable rate Federal Home Loan Bank of San Francisco advances. The hedge strategy converts LIBOR based variable rate of interest on active and forecasted Federal Home Loan Bank of San Francisco advances to fixed interest rates.

During March of 2016, we terminated all of our interest rate swaps (active and forward starting) and simultaneously paid off the $75.0 million Federal Home Loan Bank of San Francisco borrowing (the “hedged instrument”). Prior to the time of termination, a $2.3 million unrealized pretax loss on swaps was carried in *Other Liabilities* in our *Consolidated Balance Sheets.* At termination, we immediately reclassified the loss to noninterest expense.

The following table summarizes our interest rate swap contracts with counterparties outstanding at December 31, 2015. The interest rate swap contracts were made with a single issuer and include the right of offset.

(Amounts in thousands)

Description	**We Pay Fixed**	**We Receive Variable (1)**	**Notional Amount**	**Effective Date**	**Maturity Date**
Interest rate swap	2.64 %	0.33 %	$ 75,000	August 3, 2015	August 1, 2016
Forward starting interest rate swap	3.22 %	Variable	$ 75,000	August 1, 2016	August 1, 2017

(1) Rate floats to three month LIBOR payable quarterly on February 1, May 1, August 1, and November 1.

The following table lists the active and forward starting interest rate swap derivatives separately that were in a liability (loss) position, and the fair value of such derivatives at March 31, 2016, and December 31, 2015. There were no interest rate swap derivatives that were in an asset (gain) position at March 31, 2016, or at December 31, 2015.

(Amounts in thousands)		**Liability Derivatives**	
		March 31,	**December 31,**
Description	**Balance Sheet Location**	**2016**	**2015**
Interest rate swap	Cash flow hedge	$ —	$ 869
Forward starting interest rate swap	Cash flow hedge	—	1,500
Total		$ —	$ 2,369

The following table summarizes the losses recorded during the three months ended March 31, 2016 and 2015, and their locations within the *Consolidated Statements of Operations*.

(Amounts in thousands)		**Three Months Ended March 31,**	
Description	**Consolidated Statement of Operations Location**	**2016**	**2015**
Interest rate swap [(1)]	Interest on term debt	$396	$295
Forward starting interest rate swap - terminated[(2)]	Other noninterest expense	2,325	—
Total		$2,721	$295

[(1)] Losses represent tax effected amounts reclassified from accumulated other comprehensive income pertaining to net settlements recorded during the period on active interest rate swaps.

[2] Losses represent tax effected amounts reclassified from accumulated other comprehensive income pertaining to the terminated active and forward starting interest rate swaps.

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Notes to Consolidated Financial Statements (Unaudited)

The following table summarizes the loss, net of tax, on all derivative instruments (active and forward starting) designated as cash flow hedges that were reclassified from accumulated other comprehensive income into earnings during the three months ended March 31, 2016 and 2015.

(Amounts in thousands)	**Three Months Ended March 31,**	
Description	**2016**	**2015**
Interest rate swaps	$1,601	$174

The following table summarizes the derivatives that have a right of offset at December 31, 2015.

(Amounts in thousands)	**Gross Amounts of Recognized Assets / (Liabilities)**	**Gross Amounts Offset In The Consolidated Balance Sheets**	**Net Amounts of Assets / (Liabilities) Included In The Consolidated Balance Sheets**	**Gross Amounts Not Offset In The Consolidated Balance Sheets**	
				Collateral Posted	**Net Amount**
December 31, 2015					
Derivative liabilities					
Interest rate swaps	$ (2,369)	$ —	$(2,369)	$ 4,008	$ 1,639

Derivative financial instruments contain an element of credit risk if counterparties are unable to meet the terms of the contract. Credit risk associated with derivative financial instruments is measured as the net replacement cost should the counterparties fail to perform under the terms of those contracts. Assuming no recoveries of underlying collateral, credit risk is measured by the market value of the derivative financial instrument.

The contracts with the derivative counterparties contain a provision where if we fail to maintain our status as a well/adequately capitalized institution, then the counterparty could terminate the derivative positions and we would be required to settle our obligations under the agreements. Similarly, we could be required to settle our obligations under certain of our agreements if specific regulatory events occur, such as if we were issued a prompt corrective action directive or a cease and desist order, or if certain regulatory ratios fall below specified levels.

We were required to post collateral against the obligations of $2.4 million at December 31, 2015. Accordingly, we pledged three mortgage backed securities with an aggregate par value of $3.8 million and an aggregate fair value of $4.0 million. In March of 2016, upon the termination of all of our interest rate swaps the securities were returned to us.

NOTE 15. FAIR VALUES

Estimated fair values are disclosed for financial instruments for which it is practicable to estimate fair value. These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering our entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

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Notes to Consolidated Financial Statements (Unaudited)

The following table presents estimated fair values of our financial instruments as of March 31, 2016 and December 31, 2015, whether or not recognized or recorded at fair value in the *Consolidated Balance Sheets*. The table indicates the fair value hierarchy of the valuation techniques we utilized to determine such fair value.

Non-financial assets and non-financial liabilities defined by the FASB ASC 820, *Fair Value Measurement*, such as Bank premises and equipment, deferred taxes and other liabilities are excluded from the table. In addition, we have not disclosed the fair value of financial instruments specifically excluded from disclosure requirements of FASB ASC 825, *Financial Instruments*, such as bank-owned life insurance policies.

(Amounts in thousands)	**Carrying**	**Fair Value Measurements Using**			
March 31, 2016	**Amounts**	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets					
Cash and cash equivalents	$85,750	$85,750	$—	$—	$85,750
Securities available-for-sale	$174,251	$—	$174,251	$—	$174,251
Securities held-to-maturity	$35,357	$—	$36,454	$—	$36,454
Net loans	$713,733	$—	$—	$716,318	$716,318
Federal Home Loan Bank of San Francisco stock	$4,465	$4,465	$—	$—	$4,465
Financial liabilities					
Deposits	$937,667	$—	$939,612	$—	$939,612
Term debt	$19,626	$—	$19,626	$—	$19,626
Junior subordinated debenture	$10,310	$—	$5,513	$—	$5,513

(Amounts in thousands)	**Carrying**	**Fair Value Measurements Using**			
December 31, 2015	**Amounts**	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets					
Cash and cash equivalents	$51,192	$51,192	$—	$—	$51,192
Securities available-for-sale	$159,030	$—	$159,030	$—	$159,030
Securities held-to-maturity	$35,899	$—	$36,645	$—	$36,645
Net loans	$706,329	$—	$—	$711,528	$711,528
Federal Home Loan Bank of San Francisco stock	$4,465	$4,465	$—	$—	$4,465

Financial liabilities					
Deposits	$803,735	$—	$804,490	$—	$804,490
Term debt	$94,694	$—	$94,694	$—	$94,694
Junior subordinated debenture	$10,310	$—	$5,402	$—	$5,402
Derivatives	$2,369	$—	$2,369	$—	$2,369

Fair Value Hierarchy

Level 1 valuations utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access.

Level 2 valuations utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 valuations include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 valuations are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models and similar techniques.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety.

We maximize the use of observable inputs and minimizes the use of unobservable inputs when developing fair value measurements. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

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Notes to Consolidated Financial Statements (Unaudited)

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practical to estimate that value:

Cash and cash equivalents – The carrying amounts reported in the *Consolidated Balance Sheet*s for cash and cash equivalents are a reasonable estimate of fair value. The carrying amount is a reasonable estimate of fair value because of the relatively short term between the origination of the instrument and its expected realization. Therefore, we believe the measurement of fair value of cash and cash equivalents is derived from Level 1 inputs.

Securities – Investment securities fair values are based on quoted market prices, where available, and are classified as Level 1. If quoted market prices are not available, fair values are estimated using quoted market prices or matrix pricing, which is a mathematical technique, used widely by the industry that relies on the securities relationship to other benchmark securities, and are classified as Level 2.

Net Loans – For variable rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying values. For fixed rate loans, projected cash flows are discounted back to their present value based on specific risk adjusted spreads to the U.S. Treasury Yield Curve, with the rate determined based on the timing of the cash flows. The ALLL is considered to be a reasonable estimate of loan discount for credit quality concerns. Given that there are commercial loans with specific terms that are not readily available; we believe the fair value of loans is derived from Level 3 inputs.

Federal Home Loan Bank of San Francisco stock – The carrying value of Federal Home Loan Bank of San Francisco stock approximates fair value as the shares can only be redeemed by the issuing institution at par. We measure the fair value of Federal Home Loan Bank of San Francisco stock using Level 1 inputs.

Deposits – We measure fair value of maturing deposits using Level 2 inputs. The fair values of deposits were derived by discounting their expected future cash flows based on the Federal Home Loan Bank of San Francisco yield curves, and maturities. We obtained Federal Home Loan Bank of San Francisco yield curve rates as of the measurement date, and believe these inputs fall under Level 2 of the fair value hierarchy. Deposits with no defined maturities, the fair values are the amounts payable on demand at the respective reporting date.

Term Debt – For variable rate term debt, the carrying value approximates fair value. The fair value of fixed rate term debt is estimated by discounting the future cash flows using market rates at the reporting date, of which similar debt would be issued with similar credit ratings as ours and similar remaining maturities. We measure the fair value of term debt using Level 2 inputs.

Junior subordinated debenture – The fair value of the subordinated debenture is estimated by discounting the future cash flows using market rates at the reporting date, of which similar debentures would be issued with similar credit ratings as ours and similar remaining maturities. At March 31, 2016, future cash flows were discounted at 6.05%. We measure the fair value of subordinated debentures using Level 2 inputs.

Commitments – Loan commitments and standby letters of credit generate ongoing fees, which are recognized over the term of the commitment period. In situations where the borrower's credit quality has declined, we record a reserve for these unfunded commitments. Given the uncertainty in the likelihood and timing of a commitment being drawn upon, a reasonable estimate of the fair value of these commitments is the carrying value of the related unamortized loan fees plus the reserve, which is not material. As such, no disclosures are made on the fair value of commitments.

We use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Available-for-sale securities and derivatives are recorded at fair value on a recurring basis. From time to time, we may be required to record at fair value other assets on a nonrecurring basis, such as collateral dependent impaired loans and certain other assets including OREO or goodwill. These nonrecurring fair value adjustments involve the application of lower of cost or fair value accounting or write-downs of individual assets.

The following table presents information about our assets and liabilities measured at fair value on a recurring basis, and indicate the fair value hierarchy of the valuation techniques we utilized to determine such fair value, as of March 31, 2016 and December 31, 2015.

(Amounts in thousands)	**Fair Value at March 31, 2016**			
Recurring Basis	**Total**	**Level 1**	**Level 2**	**Level 3**
Available-for-sale securities				
U.S. government and agencies	$3,915	$ —	$3,915	$ —
Obligations of states and political subdivisions	61,288	—	61,288	—
Residential mortgage backed securities and collateralized mortgage obligations	51,721	—	51,721	—
Corporate securities	23,764	—	23,764	—
Commercial mortgage backed securities	14,571		14,571	—
Other investment securities [1]	18,992	—	18,992	—
Total assets measured at fair value	$174,251	$ —	$174,251	$ —

[1] Principally consists of residential

mortgage backed securities issued by both by governmental and nongovernmental agencies, and SBA pool securities.

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Notes to Consolidated Financial Statements (Unaudited)

(Amounts in thousands)	**Fair Value at December 31, 2015**			
Recurring Basis	**Total**	**Level 1**	**Level 2**	**Level 3**
Available-for-sale securities				
U.S. government and agencies	$3,943	$ —	$3,943	$ —
Obligations of states and political subdivisions	61,104	—	61,104	—
Residential mortgage backed securities and collateralized mortgage obligations	32,137	—	32,137	—
Corporate securities	33,778	—	33,778	—
Commercial mortgage backed securities	12,769	—	12,769	—
Other investment securities [1]	15,299	—	15,299	—
Total assets measured at fair value	$159,030	$ —	$159,030	$ —
Derivatives – interest rate swaps	$2,369	$ —	$2,369	$ —
Total liabilities measured at fair value	$2,369	$ —	$2,369	$ —

[1] Principally consists of residential mortgage backed securities issued by both by governmental and nongovernmental agencies, and SBA pool securities.

Recurring Items

Debt Securities – The available-for-sale securities amount in the recurring fair value table above represents securities that have been adjusted to their fair values. For these securities, we obtain fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond’s terms and conditions among other things. We have determined that the source of these fair values falls within Level 2 of the fair value hierarchy.

Forward starting interest rate swaps – The valuation of our interest rate swaps was obtained from third party pricing services. The fair values of the interest rate swaps were determined by using a discounted cash flow analysis on the expected cash flows of each derivative. The pricing analysis was based on observable inputs for the contractual terms of the derivatives, including the period to maturity and interest rate curves. We have determined that the source of these derivatives’ fair values falls within Level 2 of the fair value hierarchy.

Transfers Between Fair Value Hierarchy Levels

Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstance that caused the transfer. There were no transfers between levels of the fair value hierarchy during the three months ended March 31, 2016 or the year ended December 31, 2015.

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

We may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis. These adjustments to fair value generally result from the application of lower of cost or fair value accounting or write-downs of individual assets due to impairment. The following table presents information about our assets and liabilities at March 31, 2016 and December 31, 2015 measured at fair value on a nonrecurring basis for which a nonrecurring change in fair value has been recorded during the reporting period.

The amounts disclosed below present the fair values at the time the nonrecurring fair value measurements were made, and not necessarily the fair values as of the date reported upon.

(Amounts in thousands)	**Fair Value at March 31, 2016**			
Nonrecurring basis	**Total**	**Level 1**	**Level 2**	**Level 3**
Collateral dependent impaired loans	$941	$ —	$ —	$941
Other real estate owned	363	—	—	363
Total assets measured at fair value	$1,304	$ —	$ —	$1,304

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(Amounts in thousands)	**Fair Value at December 31, 2015**			
Nonrecurring basis	**Total**	**Level 1**	**Level 2**	**Level 3**
Collateral dependent impaired loans	$707	$ —	$ —	$707
Other real estate owned	743	—	—	743
Total assets measured at fair value	$1,450	$ —	$ —	$1,450

The following table presents the losses resulting from nonrecurring fair value adjustments for the three months ended March 31, 2016 and 2015.

(Amounts in thousands)	**Three Months Ended March 31,**	
Fair value adjustments	**2016**	**2015**
Collateral dependent impaired loans	$164	$ 52
Other real estate owned	55	15
Total	$219	$ 67

During the three months ended March 31, 2016, collateral dependent impaired loans with a carrying amount of $1.1 million were written down to their fair value of $941 thousand, resulting in a $164 thousand adjustment to the ALLL.

During the three months ended March 31, 2016, three OREO properties with an aggregate carrying value of $418 thousand were written down to their fair value of $363 thousand, resulting in a $55 thousand adjustment to the ALLL.

The loan amounts above represent impaired, collateral dependent loans that have been adjusted to fair value during the respective reporting period. When we identify a collateral dependent loan as impaired, we measure the impairment using the current fair value of the collateral, less selling costs. Depending on the characteristics of a loan, the fair value of collateral is generally estimated by obtaining external appraisals. If we determine that the value of the impaired loan is less than the recorded investment in the loan, we recognize this impairment and adjust the carrying value of the loan to fair value through the ALLL.

The loss represents charge offs or impairments on collateral dependent loans for fair value adjustments based on the fair value of collateral. The carrying value of loans fully charged off is zero. When the fair value of the collateral is based on a current appraised value, or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, we record the impaired loan as nonrecurring Level 3.

The OREO amount above represents impaired real estate that has been adjusted to fair value during the respective reporting period. The loss represents impairments on OREO for fair value adjustments based on the fair value of the real estate. The determination of fair value is based on recent appraisals of the foreclosed properties, which take into account recent sales prices adjusted for unobservable inputs, such as opinions provided by local real estate brokers and other real estate experts. OREO fair values are adjusted for estimated selling costs between 8% and 15%. We record OREO as a nonrecurring Level 3.

Limitations – Fair value estimates are made at a specific point in time, based on relevant market information and other information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time our entire holdings of a particular financial instrument. Because no market exists for a significant portion of our financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of significant judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on current on and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial assets or liabilities include deferred tax assets and liabilities, and property, plant and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

NOTE 16. PURCHASE OF FINANCIAL ASSETS

On February 27, 2015, we purchased $6.4 million of commercial real estate loans. We are servicing the loans and they were purchased without recourse. We purchased a total par value of $6.4 million in loans with accrued interest at the settlement date of $17 thousand at a net premium of $91 thousand in exchange for a cash payment of $6.5 million.

The fair value was equal to the price paid to acquire the portfolio as the difference between par value and cash purchase price represents the fair value adjustment.

On May 12, 2014, we agreed to purchase $40.0 million of unsecured consumer home improvement loans. The loans were purchased without recourse or servicing rights. The agreement calls for purchases up to $4.0 million per month up to a maximum par value of $40.0 million. During 2015, we agreed to purchase an additional $10.0 million increasing the maximum par value to $50.0 million. For the period from May 12, 2014 through March 31, 2016, we have paid cash totaling $78.5 million, and received cash repayments of $30.3 million for $48.2 million in net loans. We initially measured the acquired loan portfolio at a fair equal to the price paid to acquire the portfolio as the difference between the par value and cash purchase price represents the fair value adjustment.

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NOTE 17. BRANCH ACQUISITION

On March 11, 2016, we completed the purchase of five Bank of America branches located in northern California. The acquired branches are located in Colusa, Willows, Orland, Corning, and Yreka. The Bank also acquired three offsite ATM locations in Williams, Orland and Corning. The Bank paid cash consideration of $6.7 million and acquired $155.2 million in assets, primarily cash and premises. The Bank assumed $149.2 million in liabilities, primarily deposits.

The transaction provided a new source of low cost core deposits and allowed us to execute our plan to reconfigure our Balance Sheet. On March 14, 2016, we utilized a portion of that new liquidity to reduce our reliance on wholesale funding sources repaying $75.0 million to the Federal Home Loan Bank of San Francisco and redeeming $17.5 million of brokered time deposits.

The transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed, and consideration exchanged were recorded at estimated fair values on the acquisition date. Fair values are preliminary and subject to refinement as additional information regarding the closing date fair values becomes available. The Bank engaged third party specialists to assist in valuing certain assets, including the real estate and the core deposit intangible that resulted from the acquisition.

The contribution of the acquired operations of the five former Bank of America offices for the period from March 11, 2015 to March 31, 2015 was immaterial. Therefore, disclosure of supplemental pro forma financial information, especially prior period comparison is deemed neither practical nor meaningful. Additionally, the acquired operation was not considered a “significant business combination” as defined by the Securities and Exchange Commission.

The following table provides a preliminary assessment of the consideration transferred, assets purchased, and the liabilities assumed.

(Amounts in thousands)	**As Recorded by Bank of America**	**Fair Value and Other Merger Related Adjustments**	**As Recorded by the Company**
Consideration paid:			
Cash paid			$ 6,707
Total consideration			$ 6,707
Assets acquired:			
Cash and cash equivalents	$ 149,066	$ —	$ 149,066
Premises and equipment, net	1,835	2,355	4,190
Other assets	200	—	200
Core deposit intangibles	—	1,772	1,772
Total assets acquired	$ 151,101	$ 4,127	$ 155,228
Liabilities assumed:			
Deposits	$ 149,045	$ —	$ 149,045
Other liabilities	21	172	193
Total liabilities assumed	$ 149,066	$ 172	$ 149,238
Net identifiable assets acquired over liabilities assumed	$ 2,035	$ 3,955	$ 5,990
Goodwill			$ 717

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

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward Looking Statements and Risk Factors

This report includes forward-looking statements within the meaning of the Securities Exchange Act of 1934 (“Exchange Act”) and the Private Securities Litigation Reform Act of 1995. These statements are based on management’s beliefs and assumptions, and on information available to management as of the date of this document. Forward-looking statements include the information concerning possible or assumed future results of operations of the Company set forth under the heading “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Forward-looking statements may also include statements in which words such as “expects,” “anticipates,” “intend,” “plan,” “believes,” “estimate,” “consider” or similar expressions or conditional verbs such as “will,” “should,” “woul “could” are intended to identify such forward looking statements. Forward-looking statements are not guarantees of future performance. They involve risks, uncertainties and assumptions. The Company’s actual future results and shareholder values may differ materially from those anticipated and expressed in these forward-looking statements. Many of the factors that will determine these results and values are beyond the Company’s ability to control or predict.

The following factors, among others, could cause our actual results to differ materially from those expressed in such forward-looking statements:

The strength of the United States economy in general and the strength of the local economies in California in which we conduct operations;
Our failure to realize all of the anticipated benefits of our branch purchases;
Difficulties in integrating the acquired bank branches from Bank of America;
Our inability to successfully manage our growth or implement our growth strategy;
The effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System, or the Federal Reserve Board;
Continued volatility in the capital or credit markets;
Changes in the financial performance and/or condition of our borrowers;
Our concentration in real estate lending;
Developments and changes in laws and regulations, including increased regulation of the banking industry through legislative action and revised rules and standards applied by the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the California Department of Business Oversight;

Changes in consumer spending, borrowing and savings habits;
Changes in the level of our nonperforming assets and charge offs;
Deterioration in values of real estate in California and the United States generally, both residential and commercial;
Possible other-than-temporary impairment of securities held by us;
The timely development of competitive new products and services and the acceptance of these products and services by new and existing customers;
The willingness of customers to substitute competitors' products and services for our products and services;
Technological changes could expose us to new risks, including potential systems failures or fraud;
The effect of changes in accounting policies and practices, as may be adopted from time-to-time by bank regulatory agencies, the Securities and Exchange Commission ("SEC"), the Public Company Accounting Oversight Board, the Financial Accounting Standards Board ("FASB") or other accounting standards setters;
Inability to attract deposits and other sources of liquidity at acceptable costs;
Changes in the competitive environment among financial and bank holding companies and other financial service providers;
The loss of critical personnel and the challenge of hiring qualified personnel at reasonable compensation levels;
Natural disaster or recurring energy shortage, especially in California, such as earthquakes, wildfires, droughts, floods and mudslides;
Unauthorized computer access, computer hacking, cyber-attacks, electronic fraudulent activity, attempted theft of financial assets, computer viruses, phishing schemes and other security problems;
Geopolitical conditions, including acts or threats of war or terrorism, actions taken by the United States or other governments in response to acts or threats of war or terrorism and/or military conflicts, which could impact business and economic conditions in the United States and abroad; and
Our inability to manage the risks involved in the foregoing.

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If our assumptions regarding one or more of the factors affecting our forward-looking information and statements proves incorrect, then our actual results, performance or achievements could differ materially from those expressed in, or implied by, forward-looking information and statements contained in this document and in the information incorporated by reference in this document. Therefore, we caution you not to place undue reliance on our forward-looking information and statements.

Forward-looking statements should not be viewed as predictions, and should not be the primary basis upon which investors evaluate us. Any investor in our common stock should consider all risks and uncertainties discussed in "RISK FACTORS" and in "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS".

For additional information concerning risks and uncertainties related to the Company and its operations please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2015 under the heading "Risk factors". The Company undertakes no obligation to revise or publicly release the results of any revision to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The following sections discuss significant changes and trends in the financial condition, capital resources and liquidity of the Company from December 31, 2015 to March 31, 2016. Also discussed are significant trends and changes in the Company's results of operations for the three months ended March 31, 2016, compared to the same period in 2015. The consolidated financial statements and related notes appearing elsewhere in this report are unaudited. The following discussion and analysis is intended to provide greater detail of the Company's financial condition and results.

GENERAL

Bank of Commerce Holdings ("Holding Company," "we," or "us") is a corporation organized under the laws of California and a bank holding company ("BHC") registered under the Bank Holding Company Act of 1956, as amended ("BHC Act"). The Holding Company's principal business is to serve as a holding company for Redding Bank of Commerce (the "Bank" and together with the Holding Company, the "Company") which operates under two separate names (Redding

Bank of Commerce and Sacramento Bank of Commerce, a division of Redding Bank of Commerce). We have an unconsolidated subsidiary in Bank of Commerce Holdings Trust II, which was organized in connection with our prior issuance of trust preferred securities. Our common stock is traded on the NASDAQ Global Market under the symbol "BOCH."

We commenced banking operations in 1982 and with the completion of the purchase of five Bank of America branches during the first quarter of 2016, we now operate nine full service facilities in Northern California. We provide a wide range of financial services and products for business and retail customers, which are competitive with those traditionally offered by banks of similar size in California.

Our principal executive office is located at 1901 Churn Creek Road, Redding, California and the telephone number is (530) 722-3939.

EXECUTIVE OVERVIEW

Net loss available to common shareholders for the quarter ended March 31, 2016 was $960 thousand or $0.07 per share – diluted, compared to net income available to common shareholders of $1.8 million or $0.13 per share – diluted for the same period of 2015. The current quarter results were impacted by the following expenses totaling $2.8 million related to the acquisition of five Bank of America branches and the execution of our plans to reconfigure our Balance Sheet using liquidity provided by those branches:

- $2.3 million loss on termination of interest rate hedge.
- $412 thousand of branch acquisition transition costs.
- $57 thousand prepayment penalty on early repayment of $75.0 million Federal Home Loan Bank of San Francisco term debt.
- $39 thousand accelerated amortization of broker fees recorded in interest expense when $17.5 million of brokered time deposits were called and redeemed.

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In addition, unrelated to the branch acquisition, the current quarter results include the write-off of a $363 thousand deferred tax asset.

On March 11, 2016, we completed the purchase of five Bank of America branches located in Northern California. The transaction was most attractive to us because it provided a new source of low cost core deposits and allowed us to execute our plan to reconfigure our Balance Sheet. The acquisition provided approximately $142.3 million of new liquidity ($149.0 million of new deposits less payments of $6.7 million made to Bank of America). We utilized a portion of that new liquidity to reduce our reliance on wholesale funding sources repaying $75.0 million to the Federal Home Loan Bank of San Francisco and redeeming $17.5 million of brokered time deposits. We intend to use the remaining liquidity to fund future loan growth.

The acquired branches are located in Colusa, Willows, Orland, Corning, and Yreka. The Bank also acquired three offsite ATM locations in Williams, Orland and Corning.

The Bank paid cash consideration of $6.7 million and acquired $155.2 million in assets recorded at fair value, primarily cash and premises. The Bank assumed $149.2 million in liabilities recorded at fair value, primarily deposits.

Significant items for the three months ended March 31, 2016 were as follows:

Acquisition and Balance Sheet reconfiguration

The Company acquired $149.0 million of new deposits from Bank of America, which bear an average interest cost of 0.09%.
The Company paid off $75.0 million of Federal Home Loan Bank of San Francisco term debt and terminated the interest rate hedge associated with that debt eliminating future contractual interest payments on $75.0 million at 2.64% for the period from payoff to August 1, 2016; and at 3.22% for the period August 1, 2016 to August 1, 2017.

The acquisition and Balance Sheet reconfiguration reduced tangible book value by $0.35 per share. The projected earn back period is four years.
The acquisition and Balance Sheet reconfiguration reduced 2016 diluted earnings per share by $0.17. The projected earn back period is 18 months

Performance

Net loss available to common shareholders of $960 thousand for the three months ended March 31, 2016 was a decrease of $2.7 million (156%) over $1.8 million net income available to common shareholders earned during the first quarter of 2015.
Return on average assets decreased to (0.37) % in the first quarter of 2016 compared to 0.73% in the same quarter of 2015. Return on average equity decreased to (4.23) % in the first quarter of 2016 compared to 6.79% in the same quarter of 2015.
The Company's tangible book value per share decreased to $6.57 per common share at March 31, 2016 from $6.76 at December 31, 2015. The Company's net interest margin was 3.44% for the first quarter of 2016 compared to 3.52% for the fourth quarter of 2015.
The Company's efficiency ratio was 108.1% during the first three months of 2016 compared to 71.5% during the same period in 2015. Excluding $2.8 million of one-time expenses related to the acquisition and reconfiguring our Balance Sheet the efficiency ratio for the first three months of 2016 would have been 77.5%.

Credit Quality

Nonperforming assets at March 31, 2016 totaled $12.7 million or 1.18% of total assets, a decrease of $2.8 million or 1.53% of total assets compared to December 31, 2015.
Net loan loss recoveries of $315 thousand combined with continuing improved asset quality resulted in no provision for loan and lease losses during the first quarter.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

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

SUMMARY OF CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are described in Note 2 of the *Notes to the Consolidated Financial Statements* included in the Form 10-K for the year ended December 31, 2015 filed with the SEC on March 8, 2016. Some of these significant accounting policies are considered critical and require management to make difficult, subjective or complex judgments or estimates. Management believes that the following policies would be considered critical under the SEC's definition.

Valuation of Investments and Impairment of Securities

At the time of purchase, we designate the security as held-to-maturity or available-for-sale, based on its investment objectives, operational needs and intent to hold. We do not engage in trading activity. Securities designated as held-to-maturity are carried at amortized cost. We have the ability and intent to hold these securities to maturity. Securities designated as available-for-sale may be sold to implement our asset/liability management strategies and in response to changes in interest rates, prepayment rates and similar factors. Securities designated as available-for-sale are recorded at fair value and unrealized gains or losses, net of income taxes, are reported as part of accumulated other comprehensive income (loss), a separate component of shareholders' equity. Gains or losses on sale of securities are based on the specific identification method. The market value and underlying rating of the security is monitored for quality. Securities may be adjusted to reflect changes in valuation as a result of other-than-temporary declines in value. 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 rate investments, from changes in interest rates. At each financial statement date, management assesses each investment to determine if impaired investments are temporarily impaired or if the impairment is other-than-temporary based upon the positive and negative evidence available. Evidence evaluated includes, but is not limited to, industry analyst reports, credit market conditions, and interest rate trends.

When an investment is other-than-temporarily impaired, we assess whether we intend to sell the security, or it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis less any current-period credit losses. If we intend to sell the security or if it is more likely than not that we will be required to sell security before recovery of the amortized cost basis, the entire amount of other-than-temporary impairment is recognized in earnings.

For debt securities that are considered other-than-temporarily impaired and that we do not intend to sell and will not be required to sell prior to recovery of our amortized cost basis, we separate the amount of the impairment 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 investment's amortized cost basis and the present value of its expected future cash flows.

The remaining differences between the investment's fair value and the present value of future expected cash flows is deemed to be due to factors that are not credit related and is recognized in other comprehensive income. Significant judgment is required in the determination of whether other-than-temporary impairment has occurred for an investment. We follow a consistent and systematic process for determining other-than-temporary impairment loss. We have designated the ALCO responsible for the other-than-temporary evaluation process.

The ALCO Committee's assessment of whether other-than-temporary impairment loss should be recognized incorporates both quantitative and qualitative information including, but not limited to: (1) the length of time and the extent of which the fair value has been less than amortized cost, (2) the financial condition and near term prospects of the issuer, (3) our intent and ability to retain the investment for a period of time sufficient to allow for an anticipated recovery in value, (4) whether the debtor is current on interest and principal payments, and (5) general market conditions and industry or sector specific outlook. See Note 4 *Securities* in the *Notes to Consolidated Financial Statements* in this document for further detail on other-than-temporary impairment and the securities portfolio.

Allowance for Loan and Lease Losses

ALLL is based upon estimates of loan and lease losses and is maintained at a level considered adequate to provide for probable losses inherent in the outstanding loan portfolio. The allowance is increased by provisions charged to expense and reduced by net charge offs. In periodic evaluations of the adequacy of the allowance balance, management considers our past loan and lease loss experience by type of credit, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, current economic conditions and other factors. Management reviews the ALLL on a monthly basis and conducts a formal assessment of the adequacy of the ALLL on a quarterly basis. These assessments include the periodic re-grading of classified loans based on changes in their individual credit characteristics including delinquency, seasoning, recent financial performance of the borrower, economic factors, changes in the interest rate environment and other factors as warranted. Loans are initially graded when originated. They are reviewed as they are renewed, when there is a new loan to the same borrower and/or when identified facts demonstrate heightened risk of default. Confirmation of the quality of our grading process is obtained by independent reviews conducted by outside consultants specifically hired for this purpose and by periodic examination by various bank regulatory agencies. Management monitors delinquent loans continuously and identifies problem loans to be evaluated individually for impairment testing. For loans that are determined impaired, formal impairment measurement is performed at least quarterly on a loan-by-loan basis.

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Our method for assessing the appropriateness of the allowance includes specific allowances for identified problem loans, an allowance factor for categories of credits and allowances for changing environmental factors (e.g., portfolio trends, concentration of credit, growth, economic factors). Allowances for identified problem loans are based on specific analysis of individual credits. Loss estimation factors for loan categories are based on analysis of local economic factors applicable to each loan category. Allowances for changing environmental factors are management's best estimate of the probable impact these changes would have on the loan portfolio as a whole. See Note 5 *Loans* in the *Notes to Consolidated Financial Statements* in this document for further detail on the ALLL and the loan portfolio.

Income Taxes

Income taxes reported in the consolidated financial statements are computed based on an asset and liability approach. We recognize the amount of taxes payable or refundable for the current year, and deferred tax assets and liabilities for the expected future tax consequences that have been recognized in the consolidated financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the consolidated financial statements and the tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. We record net deferred tax assets to the extent it is more likely than not that they will be realized. In evaluating our ability to recover the deferred tax assets, management considers all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial operations.

In projecting future taxable income, management develops assumptions including the amount of future state and federal pre-tax operating income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates being used to manage the underlying business. We file consolidated federal and combined state income tax returns.

ASC 740-10-55 *Income Taxes* requires a two-step process that separates recognition from measurement of tax positions. We recognize the financial statement effect of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination by a taxing authority. The measurement process is applied only after satisfying the recognition requirement and determines what amount of a tax position will be sustainable upon a potential examination or settlement. If upon measuring, the tax position produces a range of potential tax benefits, we may claim the highest tax benefit from that range as long as it is over 50% likely to be realized using a probability analysis.

We believe that all of the tax positions we have taken, meet the more likely than not recognition threshold. To the extent tax authorities disagree with these tax positions, our effective tax rates could be materially affected in the period of settlement with the taxing authorities.

Derivative Financial Instruments and Hedging Activities

During March of 2016, we terminated all of our interest rate swaps (active and forward starting) and simultaneously paid off the $75.0 million Federal Home Loan Bank of San Francisco borrowing (the "hedged instrument"). At the time of termination, the interest rate swaps were carried at a $2.3 million loss in our *Consolidated Balance Sheets.* Accordingly, we immediately reclassified $1.4 million in unrealized losses from other comprehensive income into earnings resulting in a pre-tax loss of $2.3 million recorded in noninterest expense.

We used derivatives to hedge the risk of changes in market interest rates to limit the impact on earnings and cash flows relating to specific groups of assets and liabilities. During 2015 and the first quarter of 2016, we utilized interest rate swaps (the "hedging instrument") with other major financial institutions (counterparties) to hedge interest expenses associated with certain Federal Home Loan Bank of San Francisco borrowings (the "hedged instrument"). We do not use derivative instruments for trading or speculative purposes.

For derivative financial instruments accounted for as hedging instruments, we formally designate and document, at inception, the financial instrument as a hedge of a specific underlying exposure, the risk management objective, and the manner in which effectiveness of the hedge will be assessed. We formally assess both at inception and at each reporting period thereafter, whether the derivative financial instruments used in hedging transactions are effective in offsetting changes in fair value or cash flows of the related underlying exposures. Any ineffective portion of the change in cash flows of the instruments is recognized immediately into earnings.

ASC 815-10, *Derivatives and Hedging* ("ASC 815") requires companies to recognize all derivative instruments as assets or liabilities at fair value in the *Consolidated Balance Sheets*. In accordance with ASC 815, we have designated our interest rate swaps as cash flow hedges of certain active and forecasted variable rate Federal Home Loan Bank of San Francisco advances. Changes in the fair value of the hedging instrument in cash flow hedges are recorded in accumulated other comprehensive income until earnings are impacted by the hedged instrument. No components of our hedging instruments are excluded from the assessment of hedge effectiveness in hedging exposure to variability in cash flows.

Classification of the gain or loss in the *Consolidated Statements of Operations* upon release from accumulated other comprehensive income is the same as that of the underlying exposure. We discontinue the use of hedge accounting prospectively when (1) the derivative instrument is no longer effective in offsetting changes in fair value or cash flows of the underlying hedged item; (2) the derivative instrument expires, is sold, terminated, or exercised; or (3) designating the derivative instrument as a hedge is no longer appropriate. When we discontinue hedge accounting because it is no longer probable that an anticipated transaction will occur in the originally expected period, or within an additional two-month period thereafter, changes to fair value that were in accumulated other comprehensive income are recognized immediately in earnings.

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At December 31, 2015, we had one active interest rate swap, and one forward starting interest rate swap to hedge interest rate risk associated with current and forecasted variable rate Federal Home Loan Bank of San Francisco advances. The hedge strategy converts LIBOR based variable rate of interest on active and forecasted Federal Home Loan Bank of San Francisco advances to fixed interest rates.

The following table summarizes our interest rate swap contracts with counterparties outstanding at December 31, 2015. The interest rate swap contracts are made with a single issuer and include the right of offset.

(Amounts in thousands)

Description	**We Pay Fixed**	**We Receive Variable** [1]	**Notional Amount**	**Effective Date**	**Maturity Date**
Interest rate swap	2.64%	0.33 %	$ 75,000	August 3, 2015	August 1, 2016
Forward starting interest rate swap	3.22%	Variable	$ 75,000	August 1, 2016	August 1, 2017

[1] Rate floats to three month LIBOR payable quarterly on February 1, May 1, August 1, and November 1.

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 and derivatives 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 nonrecurring basis, such as certain impaired loans held for investment, ("OREO") and goodwill. These nonrecurring 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, we use our 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 consolidated financial statements. Additional information on our use of fair value measurements and our related valuation methodologies is provided in Note 15 *Fair Values* in the *Notes to Consolidated Financial Statements* incorporated in this document.

SOURCES OF INCOME

We derive our income primarily from net interest income, which is the difference between the interest income we receive on interest-earning assets and the interest expense we pay on interest-bearing liabilities. Other sources of noninterest income include fees earned on deposit related services, payroll processing, gain on sale of available-for-sale securities, earnings on bank-owned life insurance and dividends on Federal Home Loan Bank of San Francisco stock.

Our income depends to a great extent on net interest income, which correlates strongly with certain interest rate characteristics. These interest rate characteristics are highly sensitive to many factors that are beyond our control, including general economic conditions, inflation, recession, and the policies of various governmental and regulatory agencies, the Federal Reserve Board in particular. In recent years, we originated higher volumes of longer term fixed rate loans. These loans, combined with the structure of our investment portfolio, the use of floors in the pricing of our variable rate loans and funding mix caused the Company to become liability sensitive, which would negatively impact earnings in a rising interest rate environment. To mitigate this liability sensitive position, we entered into an interest rate swap on a portion of our Federal Home Loan Bank of San Francisco borrowings and have been working to shorten the average duration of our investment portfolio. These actions have brought our interest rate risk profile to a position that is neutral or slightly liability sensitive.

Net interest income reflects both the amount of earning assets we hold and our net interest margin, which is the difference between the yield we earn on our assets and the interest rate we pay to fund those assets. As a result, changes in either our net interest margin or the amount of earning assets we hold will affect our net interest income and earnings.

Increases or decreases in interest rates could adversely affect our net interest margin. Although the yield we earn on our assets and funding costs tend to move in the same direction in response to changes in interest rates, one can rise or fall faster than the other, and cause our net interest margin to expand or contract. Many of our assets are tied to prime rate, so they may adjust faster in response to changes in interest rates. As a result, when interest rates fall, the yield we earn on our assets may fall faster than our ability to reprice a large portion of our liabilities, causing our net interest margin to contract.

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Changes in the slope of the yield curve, the spread between short term and long term interest rates, could also reduce our net interest margin. Normally, the yield curve is upward sloping, which means that short term rates are lower than long term rates. Because our liabilities tend to be shorter in duration than our assets, when the yield curve flattens or even inverts, we could experience pressure on our net interest margin as our cost of funds increases relative to the yield we can earn on our assets.

We assess our interest rate risk by estimating the effect on our earnings under various simulated scenarios that differ based on assumptions including the direction, magnitude and speed of interest rate changes, and the slope of the yield curve.

There is always the risk that changes in interest rates could reduce our net interest income and earnings in material amounts, especially if actual conditions turn out to be materially different than simulated scenarios. For example, if interest rates rise or fall faster than we assumed or the slope of the yield curve changes, we may incur significant losses on debt securities we hold as investments. To reduce our interest rate risk, we may rebalance our investment and loan portfolios, refinance our debt and take other strategic actions, which may result in losses or expenses.

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RESULTS OF OPERATIONS

OVERVIEW

Net income available to common shareholders for the first quarter of 2016 decreased $2.7 million over the first quarter of 2015. The difference is centered in branch acquisition and Balance Sheet reconfiguration costs totaling $2.8 million along with the write-off of a $363 thousand deferred tax asset.

Compared to the first quarter of 2015, net interest income decreased $65 thousand and noninterest income increased $95 thousand. Aside from the branch acquisition and Balance Sheet reconfiguration costs ($2.8 million), noninterest expense for the three months ended March 31, 2016 increased $613 thousand.

During the three months ended March 31, 2016, we recorded an income tax benefit related to operating losses of $151 thousand and wrote-off a $363 thousand deferred tax asset; a net expense of $212 thousand. This compared to income tax expense of $829 thousand for the same period a year ago. Net loss per share available to common shareholders was $0.07 – diluted for the three months ended March 31, 2016 compared to net income available to common shareholders per share of $0.13 - diluted for the same period a year ago, and net income available to common shareholders per share - diluted of $0.13 for the prior period.

Compared to the prior quarter, current quarter earnings per share available to common shareholders do not include preferred stock dividends and preferred stock extinguishment costs on preferred stock. All preferred stock was redeemed during the fourth quarter of 2015.

We continued our quarterly cash dividends of $0.03 per share during the quarter ended March 31, 2016. In determining the amount of dividend to be paid, management gives consideration to capital preservation objectives, expected asset growth, projected earnings, the overall dividend pay-out ratio, and the dividend yield.

Return on Average Assets, Average Total Equity and Common Shareholders' Equity

The following table presents the returns on average assets, average total equity and average common shareholders' equity for the three months ended March 31, 2016 and 2015. For each of the periods presented, the table includes the calculated ratios based on reported net income and net income available to common shareholders as shown in the *Consolidated Statements of Operations* incorporated in this document.

	For the Three Months Ended	
	March 31, 2016	**March 31, 2015**
Return on average assets:		
Net income	(0.37)%	0.75 %
Income available to common shareholders	(0.37)%	0.73 %
Return on average total equity:		
Net income	(4.23)%	6.98 %
Income available to common shareholders	(4.23)%	6.79 %
Return on average common shareholders’ equity:		
Net income	(4.23)%	8.62 %
Income available to common shareholders	(4.23)%	8.39 %

NET INTEREST INCOME AND NET INTEREST MARGIN

Net interest income is the largest source of our operating income. For the three months ended March 31, 2016 compared to the same period a year ago net interest income decreased $65 thousand.

Interest income for the three months ended March 31, 2016 increased $378 thousand or 4% to $9.9 million. Income from interest and fees on loans and interest on interest bearing deposits due from banks increased $544 thousand while interest on securities decreased $166 thousand.

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Interest expense for the first three months of 2016 increased $443 thousand or 38% to $1.6 million. Interest expense on term debt increased $433 thousand while all other interest expense on deposits and lease liabilities increased only $10 thousand. The significant increase in interest on term debt results from:

Interest expense of $296 thousand incurred on $20.0 million of new term debt issued during the fourth quarter of 2015.

Interest expense on Federal Home Loan Bank of San Francisco borrowings increased $137 thousand over a year previous due to increased net settlement expense associated with the active interest rate swap.

The net interest margin (net interest income as a percentage of average interest earning assets) on a fully tax-equivalent basis was 3.57% for the three months ended March 31, 2016, a decrease of 29 basis points as compared to the same period a year ago. The decrease in net interest margin resulted from a 14 basis point decrease in tax-equivalent yield on average earning assets and a 15 basis point increase in interest expense to fund average earning assets. The decrease in the tax equivalent yield on average earning assets was primarily due to decreased yields in the securities portfolio. The increased rate on average interest bearing liabilities resulted from the interest on $20.0 million of new term debt issued during the fourth quarter of 2015. Interest on this debt totaled $296 thousand during the first quarter of 2016 and reduced the net interest margin by 12 basis points.

The current quarter tax equivalent net interest margin of 3.57% decreased eight basis points as compared to the prior quarter ended December 31, 2015. This was caused by the cost of new debt previously described partially offset by decreased rates paid on interest bearing deposits.

During the first quarter of 2016, deposit balances increased $175.7 million and $134.0 million compared to the same period a year ago and the prior quarter ended December 31, 2015, respectively, primarily due to our branch acquisition. Our overall cost of interest bearing deposits decreased to 0.37% for the quarter ended March 31, 2016 from 0.40% for the same period a year ago and from 0.38% for the prior quarter ended December 31, 2015.

Our future net interest margin will be enhanced by deploying the remaining cash provided by these deposits into higher yielding assets and by the elimination of our contractual interest payments on $75.0 million Federal Home Loan Bank of San Francisco borrowings.

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Average Balances, Interest Income/Expense and Yields/Rates Paid

The following table presents condensed average balance sheet information, together with interest income and yields earned on average interest earning assets, and interest expense and rates paid on average interest-bearing liabilities for the three months ended March 31, 2016 and 2015.

	Three Months Ended March 31, 2016			**Three Months Ended March 31, 2015**		
(Amounts in thousands)	**Average Balance**	**Interest**	**Yield/ Rate**	**Average Balance**	**Interest**	**Yield/ Rate**
Interest-earning assets:						
Net loans [1]	$720,795	$ 8,451	4.72 %	$673,120	$ 7,911	4.77 %
Taxable securities	119,917	784	2.63 %	136,557	945	2.81 %
Tax-exempt securities	77,852	594	3.07 %	77,316	599	3.14 %
Interest-bearing deposits in other banks	51,254	75	0.59 %	25,893	71	1.11 %
Average interest-earning assets	969,818	9,904	4.11 %	912,886	9,526	4.23 %
Cash and due from banks	12,301			10,295		
Premises and equipment, net	12,384			12,195		
Other assets	39,700			43,540		
Average total assets	$1,034,203			$978,916		
Interest-bearing liabilities:						
Interest-bearing demand	$323,771	122	0.15 %	$275,954	116	0.17 %
Savings deposits	96,027	45	0.19 %	91,152	54	0.24 %
Certificates of deposit	221,836	597	1.08 %	246,707	591	0.97 %
Net term debt	91,444	782	3.44 %	84,111	349	1.68 %
Junior subordinated debentures	10,310	54	2.11 %	10,310	47	1.85 %
Average interest-bearing liabilities	$743,388	1,600	0.87 %	$708,234	1,157	0.66 %
Noninterest-bearing demand	182,539			148,923		
Other liabilities	16,969			17,141		
Shareholders’ equity	91,307			104,618		
Average liabilities and shareholders’ equity	$1,034,203			$978,916		
Net interest income and net interest margin		$ 8,304	3.44 %		$ 8,369	3.72 %
Tax equivalent net interest margin [2]			3.57 %			3.86 %

Interest income on loans includes fee expense of approximately $(315) thousand and $(59) thousand for the three months ended March 31, 2016 and 2015, respectively.

(1) Average nonaccrual loans of $10.4 million and $20.5 million for the three months ended March 31, 2016 and 2015 are included, respectively.

(2) Tax-exempt income has been adjusted to a tax equivalent basis at a 34% tax rate. The amount of such adjustments was an addition to recorded income of approximately $306 thousand and $309 thousand for the three months ended March 31, 2016 and 2015, respectively.

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Analysis of Changes in Net Interest Income

The following table sets forth a summary of the changes in tax equivalent net interest income due to changes in average asset and liability balances (volume variance) and changes in average rates (rate variance) for the three months ended March 31, 2016 and 2015. Changes in tax equivalent interest income and expense, which are not attributable specifically to either volume or rate, are allocated proportionately between both variances.

	Three Months Ended March 31, 2016 Over Three Months Ended March 31, 2015		
(Amounts in thousands)	**Volume**	**Rate**	**Total**
Increase (decrease) in interest income:			
Net loans	$559	$(19)	$540
Taxable securities	(111)	(50)	(161)
Tax-exempt securities [1]	6	(14)	(8)
Interest-bearing deposits in other banks	8	(4)	4
Total increase (decrease)	462	(87)	375
Increase (decrease) in interest expense:			
Interest-bearing demand	15	(9)	6
Savings deposits	3	(12)	(9)
Certificates of deposit	(26)	32	6
Net term debt	33	400	433
Junior subordinated debentures	—	7	7
Total (decrease) increase	25	418	443
Net increase (decrease)	$437	$(505)	$(68)

[1] Tax-exempt income has been adjusted to tax equivalent basis at a

34% tax
rate.

PROVISION FOR LOAN AND LEASE LOSSES

We made no provision for loan and lease losses during the three months ended March 31, 2016 and 2015. See Note 5 - *Loans* in the *Notes to Consolidated Financial Statements* for further discussion.

NONINTEREST INCOME

Noninterest income for the three months ended March 31, 2016 was $949 thousand, an increase of $95 thousand, or 11%, compared to the same period a year ago. The following table presents the key components of noninterest income for the three months ended March 31, 2016 and 2015.

	Three Months Ended March 31,			
(Amounts in thousands)	**2016**	**2015**	**Change Amount**	**Change Percent**
Noninterest income:				
Service charges on deposit accounts	$72	$49	$ 23	47 %
Payroll and benefit processing fees	160	148	12	8 %
Earnings on cash surrender value – life insurance	156	165	(9)	(5)%
Gain on investment securities, net	94	215	(121)	(56)%
Other	467	277	190	69 %
Total noninterest income	$949	$854	$ 95	11 %

Noninterest income for the three months ended March 31, 2016 increased $95 thousand compared to the same period a year ago. During the first quarter of 2016, we recorded a $176 thousand gain on payoff of a purchased impaired loan. Also, during the current quarter we recorded net gains on sale of available-for-sale investment securities of $94 thousand compared to net gains of $215 thousand for the same period a year ago. During the three months ended March 31, 2016, we purchased 28 securities with weighted average yields of 2.24%. During the same period, we sold 17 securities with weighted average yields 2.38%.

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NONINTEREST EXPENSE

Noninterest expense for the three months ended March 31, 2016 was $10.0 million, an increase of $3.4 million or 52% compared to the same period a year ago. The following table presents the key elements of noninterest expense for the three months ended March 31, 2016 and 2015.

	Three Months Ended March 31,			
(Amounts in thousands)	**2016**	**2015**	**Change Amount**	**Change Percent**
Noninterest expense:				
Salaries & related benefits	$4,229	$3,910	$ 319	8 %
Premises & equipment	789	734	55	7 %
Write-down of other real estate owned	55	—	55	100 %
Federal Deposit Insurance Corporation insurance premium	156	207	(51)	(25)%
Data processing fees	304	242	62	26 %
Professional service fees	436	388	48	12 %
Branch acquisition costs	412	—	412	100 %
Loss on cancellation of interest rate swap	2,325	—	2,325	100 %
Other	1,295	1,112	183	16 %
Total noninterest expense	$10,001	$6,593	$ 3,408	52 %

The current quarter noninterest expenses were impacted by the following expenses totaling $2.8 million related to the acquisition of five Bank of America branches and the execution of our plans to reconfigure our Balance Sheet using liquidity provided by those branches:

- $2.3 million loss on termination of interest rate hedge.
- $412 thousand of branch acquisition transition costs.
- $57 thousand prepayment penalty on early repayment of $75.0 million Federal Home Loan Bank of San Francisco term debt.

Aside from the branch acquisition and Balance Sheet reconfiguration costs listed above, noninterest expense for the three months ended March 31, 2016 increased $613 thousand compared to the same period a year ago. The increase was primarily driven by the following negative items:

Staff increases and salary adjustments totaling $402 thousand, exclusive of our newly acquired offices.
Salaries and benefits at our newly acquired offices totaling $101 thousand.
Change in employee vacation utilization/carryover policy costing $203 thousand.
Increased office and postage of $117 thousand.

The increase in noninterest expense compared to the same period a year ago was partially offset by the following positive items:

Salary Continuation Plan savings of $186 thousand.
The first quarter of 2015 included $147 thousand write-down of a fixed asset.

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INCOME TAXES

Our provision for income taxes includes both federal and state income taxes and reflects the application of federal and state statutory rates to our income before taxes. The following table reflects our tax provision and the related effective tax rate for the periods indicated.

	For the Three Months Ended March 31,	
(Amounts in thousands)	**2016**	**2015**
Provision for income taxes	$212	$829
Effective tax rate	(28.34)%	31.52%
Provision for income taxes - excluding DTA write-off	$(151)	$829
Effective tax rate - excluding DTA write-off	20.19 %	31.52%

During the three months ended March 31, 2016, we recorded an income tax benefit related to operating losses of $151 thousand and wrote-off a $363 thousand deferred tax asset; a net expense of $212 thousand. This compared to income tax expense of $829 thousand for the same period a year ago. Pre-tax income for 2016 is projected to be less than in 2015, while permanent deductions and tax credits are anticipated to remain relatively unchanged resulting in a decrease in the effective tax rate for 2016. As a result, excluding the write-off of the $363 thousand deferred tax asset, the Company’s effective tax rate decreased from 31.52% in 2015 to 20.19% during the current quarter.

The $363 thousand deferred tax asset written off during the first quarter was associated with our investment in affordable housing partnerships. The deferred tax asset represented the timing difference between the book amortization of the investments and the Bank’s share of the tax deductible losses incurred by the projects reported on the partnerships’ Schedule K-1. In accordance with ASC 323 deferred tax treatment for these items is not permissible under the proportional amortization method of accounting.

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FINANCIAL CONDITION

CONSOLIDATED BALANCE SHEETS

As of March 31, 2016, we had total consolidated assets of $1.1 billion, gross loans of $724.2 million, allowance for loan and lease losses (“ALLL”) of $11.5 million, total deposits of $937.7 million, and shareholders’ equity of $90.7 million.

We continued to maintain a strong liquidity position during the reporting period. As of March 31, 2016, we maintained noninterest-bearing cash positions at the Federal Reserve Bank and correspondent banks in the amount of $15.0 million. We also held interest-bearing deposits in the amount of $70.8 million. The sizeable increase in interest-bearing deposits derives from liquidity provided by the recent branch acquisition. It is anticipated that much of this liquidity will be deployed into new loans over the remainder of the year.

Available-for-sale investment securities totaled $174.3 million at March 31, 2016, compared to $159.0 million at December 31, 2015. Our available-for-sale investment portfolio provides a secondary source of liquidity to fund other higher yielding asset opportunities, such as loan originations and wholesale loan purchases.

During the first three months of 2016, we purchased 28 securities with a par value of $39.2 million and weighted average yield of 2.24% and sold 17 securities with a par value of $18.8 million and weighted average yield of 2.38%. The sales activity resulted in $94 thousand in net realized gains for the three months ended March 31, 2016. During the three months ended March 31, 2016, we also received $5.5 million in proceeds from principal payments, calls and maturities within the available-for-sale investment securities portfolio.

During the current quarter, our securities transactions were focused on deploying a portion of the cash acquired from the Bank of America branch acquisition into moderate term securities. Sales were focused on longer-term municipal and corporate bonds, as well as mortgage-backed and asset-backed securities with extended cash flows or with a high probability of cash flows extending as interest rates increase.

Overall, our investment strategy reflects the continuing expectation of slowly rising rates across the yield curve. We continue to seek out opportunities to reduce the overall duration of the portfolio and accelerate cash flows. This strategy could entail recognizing small losses within the portfolio to meet these longer term objectives.

At March 31, 2016, our net unrealized gains on available-for-sale investment securities were $1.7 million compared to $3.1 million and $1.6 million at March 31, 2015 and December 31, 2015, respectively. The decrease in net unrealized gains between March 31, 2015 and March 31, 2016 is primarily due to interest rate changes over the past 12 months.

We recorded gross loan balances of $724.2 million at March 31, 2016, compared to $716.6 million at December 31, 2015; an increase of $7.6 million. The increase in gross loans compared to the prior year was driven by organic loan originations.

The ALLL at March 31, 2016 increased $315 thousand to $11.5 million compared to $11.2 million at December 31, 2015. During the three months ended March 31, 2015 and 2016 there were no provisions for loan and lease losses. Net loan loss recoveries were $315 thousand during the three months ended March 31, 2016, compared to net recoveries of $476 thousand during the same period a year previous. At March 31, 2016, relying on our ALLL methodology, which uses criteria such as risk weighting and historical loss rates, and given the ongoing improvements in asset quality, we believe the ALLL is adequate. There is, however, no assurance that future loan and lease losses will not exceed the levels provided for in the ALLL and could possibly result in additional charges to the provision for loan and lease losses.

Nonperforming loans, which include nonaccrual loans and accruing loans past due over 90 days, decreased by $2.4 million to $11.7 million, or 1.62% of gross loans, as of March 31, 2016, compared to $14.1 million, or 1.97% of gross loans as of December 31, 2015. Past due loans as of March 31, 2016 decreased $4.4 million to $6.9 million, compared to $11.2 million as of December 31, 2015. The decrease in past due loans was primarily attributable to the repayment of a $4.5 million commercial real estate loan. We believe that risk grading for past due loans appropriately reflects the risk associated with the past due loans. See Note 5 *Loans* in the *Notes to Consolidated Financial Statements* in this document for further detail on the ALLL and the loan portfolio.

Our OREO balance at March 31, 2016 was $1.0 million compared to $1.4 million at December 31, 2015. For the three months ended March 31, 2016, there were no foreclosed properties transferred to OREO and we sold five properties with balances of $358 thousand for a net loss of $125 thousand. During the quarter ended March 31, 2016, we recognized a write-down for three properties totaling $55 thousand. See Note 6, *Other Real Estate Owned* in the *Notes to Consolidated Financial Statements* in this document, for further details relating to our OREO portfolio. We remain committed to working with customers who are experiencing financial difficulties to find potential solutions.

Premises and equipment totaled $15.5 million at March 31, 2016 an increase of $4.4 million compared to $11.1 million at December 31, 2015. The increase in premise and equipment is due to the branch acquisition, which includes a $2.2 million positive fair value adjustment on the purchased properties. Bank-owned life insurance increased $156 thousand during the three months ended March 31, 2016 to $22.6 million compared to $22.5 million at December 31, 2015. Our net deferred tax assets were $8.4 million at March 31, 2016 compared to $9.8 million at December 31, 2015. As part of the branch acquisition, we recorded a core deposit intangible of $1.8 million and preliminary goodwill of $717 thousand. Other assets which include the Bank's investment in low income housing tax credit partnerships and investment in Federal Home Loan Bank of San Francisco stock totaled $18.0 million at March 31, 2016 compared to $18.3 million at December 31, 2015.

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Total deposits at March 31, 2016, increased $175.7 million or 23% to $937.7 million compared to March 31, 2015, and increased $133.9 million or 17% compared to December 31, 2015. Total non-maturing deposits increased $202.1 million or 40% compared to the same date a year ago and increased $131.2 million or 23% compared to December 31, 2015. Certificates of deposit decreased $26.5 million or 10% compared to the same date a year ago and increased $2.7 million or 1% compared to December 31, 2015.

During the first quarter of 2016, the branch acquisition provided an additional $149.0 million of deposits and we called and redeemed $17.5 million of brokered certificates of deposit. The average interest rate paid during the quarter on all acquired deposits was 0.09% and on the acquired interest bearing deposits was 0.11%. At March 31, 2016, the deposits in the acquired branches totaled $148.3 million as follows:

Demand – noninterest bearing totaling $37.9 million.
Demand – interest bearing totaling $77.3 million.
Savings totaling $9.6 million.
Certificates of deposit totaling $23.5 million.

During the first quarter of 2016, we paid off $75.0 million of Federal Home Loan Bank of San Francisco term debt and terminated the interest rate hedge associated with that debt eliminating future contractual interest payments on $75.0 million at 2.64% for the period from payoff to August 1, 2016; and at 3.22% for the period August 1, 2016 to August 1, 2017.

Other liabilities which include the Bank's supplemental executive retirement plan, derivative instruments, and funding obligation for investments in qualified affordable housing partnerships increased $2.7 million to $18.8 million as of March 31, 2016 compared to $16.2 million at December 31, 2015. The increase in other liabilities includes $5.4 million owed to Bank of America as part of the final acquisition settlement accounting offset by a $2.3 million decrease related to the termination of interest rate swaps.

Investment Securities

The composition of our investment securities portfolio reflects management's investment strategy of maintaining an appropriate level of liquidity while providing a relatively stable source of interest income.

The investment securities portfolio also:

- Mitigates interest rate risk;
- Mitigates a portion of credit risk inherent in the loan portfolio;
- Provides a vehicle for the investment of excess liquidity;
- Provides a source of liquidity when pledged as collateral for lines of credit;
- Can be used as collateral for certain public funds.

Available-for-sale investment securities totaled $174.3 million at March 31, 2016, compared to $159.0 million at December 31, 2015. During the first quarter of 2016, a portion of the excess cash from the Bank of America branch acquisition was used to fund moderate term securities that will provide cash flow to fund future loan growth.

Our held-to-maturity investment portfolio is generally utilized to hold longer term securities that may have greater price risk many of which are pledged as collateral for our local agency deposit program. This portfolio includes securities with longer durations and higher coupons than securities held in the available-for-sale securities portfolio. Held-to-maturity investment securities had amortized costs of $35.4 million at March 31, 2016, compared to $35.9 million at December 31, 2015. There were no held-to-maturity securities purchased during the three months ended March 31, 2016.

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The following table presents the carrying value of the investment securities portfolio by classification and major type as of March 31, 2016 and December 31, 2015.

(Amounts in thousands)	**March 31, 2016**	**December 31, 2015**
Available-for-sale securities: [1]		
U.S. government & agencies	$3,915	$3,943
Obligations of state and political subdivisions	61,288	61,104
Mortgage backed securities and collateralized mortgage obligations	51,721	32,137
Corporate securities	23,764	33,778
Commercial mortgage backed securities	14,571	12,769
Other asset backed securities	18,992	15,299
Total	$174,251	$159,030
Held-to-maturity securities: [1]		
Obligations of state and political subdivisions	$35,357	$35,899

[1] Available-for-sale securities are reported at fair value, and held-to-maturity securities are reported at amortized cost.

The following table presents information regarding the amortized cost, maturity structure and average yield of the investment portfolio at March 31, 2016.

	Within One Year		**Over One Through Five Years**		**Over Five Through Ten Years**		**Over Ten Years**		**Total**	
	Amount	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**

(Amounts in thousands)										
Available-for-sale securities:										
U.S. government & agencies	$ —	— %	$ 3,841	3.24 %	$ —	— %	$ —	— %	$ 3,841	3.24 %
Obligations of state and political subdivisions	794	2.50 %	9,085	2.65 %	22,845	3.15 %	26,591	2.58 %	59,315	2.81 %
Mortgage backed securities and collateralized mortgage obligations	642	4.53 %	38,249	2.67 %	12,256	3.30 %	683	3.99 %	51,830	2.86 %
Corporate securities	3,019	1.02 %	11,546	2.69 %	6,616	2.78 %	2,660	2.36 %	23,841	2.46 %
Commercial mortgage backed securities	—	— %	1,939	1.43 %	—	— %	12,751	2.63 %	14,690	2.47 %
Other asset backed securities	—	— %	—	— %	4,849	1.67 %	14,172	2.73 %	19,021	2.46 %
Total	$ 4,455	1.79 %	$ 64,660	2.67 %	$ 46,566	2.98 %	$ 56,857	2.64 %	$ 172,538	2.72 %
Held-to-maturity securities:										
Obligations of state and political subdivisions	$ —	— %	$ 1,530	3.41 %	$ 16,465	2.95 %	$ 17,362	3.30 %	$ 35,357	3.14 %

The maturities for the collateralized mortgage obligations and mortgage backed securities are presented by expected average life, rather than contractual maturity. The yield on tax-exempt securities has not been adjusted to a tax-equivalent yield basis.

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Loan Portfolio

Loan Concentrations

Historically, we have concentrated our loan origination activities primarily within El Dorado, Placer, Sacramento, and Shasta counties in California. We manage our credit risk through various diversifications of our loan portfolio, the application of sound underwriting policies and procedures, and ongoing credit monitoring practices. Generally, the loans are secured by real estate or other assets located in California. Repayment is expected from the borrower's cash flows or cash flows from real estate investments.

The following table presents the composition of the loan portfolio as of March 31, 2016 and December 31, 2015.

(Amounts in thousands) **Loan Portfolio**	**March 31, 2016**	**%**	**December 31, 2015**	**%**
Commercial	$136,721	19 %	$132,805	19 %
Commercial real estate:				
Real estate - construction and land development	27,554	4	28,319	4
Real estate - commercial non-owner occupied	247,840	34	243,374	33
Real estate - commercial owner occupied	154,484	21	156,299	22
Residential real estate:				
Real estate - residential - ITIN	48,384	7	49,106	7
Real estate - residential - 1-4 family mortgage	10,947	2	11,390	2
Real estate - residential - equity lines	44,327	6	45,473	6
Consumer and other	53,986	7	49,873	7
Gross loans	724,243	100%	716,639	100%
Deferred loan fees	985		870	
Loans, net of deferred fees and costs	725,228		717,509	
Allowance for loan and lease losses	(11,495)		(11,180)	
Net loans	$713,733		$706,329	

The following table sets forth the maturity and re-pricing distribution of our gross loans outstanding as of March 31, 2016, which, based on remaining scheduled repayments of principal, were due within the periods indicated.

(Amounts in thousands)	**Within One Year**	**After One Through Five Years**	**After Five Years**	**Total**
Commercial	$42,048	$47,591	$47,082	$136,721
Commercial real estate:				
Real estate - construction and land development	6,987	3,495	17,072	27,554
Real estate - commercial non-owner occupied	2,672	48,046	197,122	247,840
Real estate - commercial owner occupied	6,611	23,155	124,718	154,484
Residential real estate:				
Real estate - residential - ITIN	—	—	48,384	48,384
Real estate - residential - 1-4 family mortgage	—	806	10,141	10,947
Real estate - residential - equity lines	1,264	1,350	41,713	44,327
Consumer and other	49,668	686	3,632	53,986
Gross loans	$109,250	$125,129	$489,864	$724,243
Loans due after one year with:				
Fixed rates		$62,699	$150,224	$212,923
Variable rates		62,430	339,640	402,070
Total		$125,129	$489,864	$614,993

Loans with unique credit characteristics

In April of 2009, we completed a loan 'swap' transaction, which included the purchase of a pool of Individual Tax Identification Number ("ITIN") residential mortgage loans. The ITIN loans are made to legal United States residents who do not possess a social security number, and are geographically dispersed throughout the United States. The ITIN loan portfolio is serviced through third parties. The majority of the ITIN loans are variable rate loans and may have an increased default risk in a rising rate environment. Worsening economic conditions in the United States may cause us to suffer higher default rates on our ITIN loans and reduce the value of the assets that we hold as collateral. In addition, if we are forced to foreclose and service these ITIN properties ourselves, we may realize additional monitoring, servicing and appraisal costs due to the geographic disbursement of the portfolio which will adversely affect our noninterest expense.

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Purchased Loans

In addition to loans we have originated, the loan portfolio includes purchased loan pools and purchased participations. Purchased loans are recorded at their fair value at the acquisition date. Credit discounts are included in the determination of fair value; therefore, an ALLL is not recorded at the acquisition date. Additional information regarding the individual purchased loan pools can be found in Note *16 Purchase of Financial Assets* in the *Notes to Consolidated Financial Statements* in this document.

The following table presents the recorded investment in purchased loans at March 31, 2016 and December 31, 2015.

(Amounts in thousands)	**March 31, 2016**			**December 31, 2015**		
Purchased Loans	**Balance**	**% of Gross Loan Portfolio**		**Balance**	**% of Gross Loan Portfolio**	
Commercial	$121	—	%	$—	—	%
Commercial real estate	42,904	6		46,999	7	
Residential real estate	57,328	8		58,471	8	
Consumer and other	51,165	8		46,783	7	
Total purchased loans	$151,518	22	%	$152,253	22	%

Asset Quality

Nonperforming Assets

Our loan portfolio is heavily concentrated in real estate, and a significant portion of our borrowers' ability to repay their loans is dependent upon the professional services, commercial real estate market and the residential real estate development industry sectors. Loans secured by real estate or other assets primarily located in California are expected to be repaid from cash flows of the borrower or proceeds from the sale of collateral. As such, our dependence on real estate secured loans could increase the risk of loss in our loan portfolio in a market of declining real estate values. Furthermore, declining real estate values negatively impact holdings of OREO.

We manage asset quality and mitigate credit risk through the application of policies designed to promote sound underwriting and loan monitoring practices. Our Loan Committee is charged with monitoring asset quality, establishing credit policies and procedures and enforcing the consistent application of these policies and procedures across the Bank. The provision for loan and lease losses charged to earnings is based upon management's judgment of the amount necessary to maintain the allowance at a level adequate to absorb probable incurred losses. The amount of provision charge is dependent upon many factors, including loan growth, net charge offs, changes in the composition of the loan portfolio, delinquencies, management's assessment of loan portfolio quality, general economic conditions that can impact the value of collateral, and other trends. The evaluation of these factors is performed through an analysis of the adequacy of the ALLL. Reviews of nonperforming, past due loans and larger credits, designed to identify potential charges to the ALLL, and to determine the adequacy of the allowance, are conducted on a monthly basis. These reviews consider such factors as the financial strength of borrowers, the value of the applicable collateral, loan and lease loss experience, estimated loan and lease losses, growth in the loan portfolio, prevailing economic conditions and other factors.

A loan is considered impaired when, based on current information and events, we determine it is probable that we will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Generally, when we identify a loan as impaired, we measure the loan for potential impairment using discount cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral. In these cases, we use the current fair value of collateral, less selling costs. The starting point for determining the fair value of collateral is through obtaining external appraisals. Generally, external appraisals are updated every six to twelve months. We obtain appraisals from a pre-approved list of independent, third party, local appraisal firms. Approval and addition to the list is based on experience, reputation, character, consistency and knowledge of the respective real estate market. At a minimum, it is ascertained that the appraiser is: (1) currently licensed in the state in which the property is located, (2) is experienced in the appraisal of properties similar to the property being appraised, (3) is actively engaged in the appraisal work, (4) has knowledge of current real estate market conditions and financing trends, (5) is reputable, and (6) is not on Freddie Mac's nor our Exclusionary List of appraisers and brokers. In certain cases, appraisals will be reviewed by another independent third party to ensure the quality of the appraisal and the expertise and independence of the appraiser. Upon receipt and review, an external appraisal is utilized to measure a loan for potential impairment.

Our impairment analysis documents the date of the appraisal used in the analysis, whether the officer preparing the report deems it current, and, if not, allows for internal valuation adjustments with justification. Typical justified adjustments might include discounts for continued market deterioration subsequent to appraisal date, adjustments for the release of collateral contemplated in the appraisal, or the value of other collateral or consideration not contemplated in the appraisal. An appraisal over one year old in most cases will be considered stale dated and an updated or new appraisal will be required. Any adjustments from appraised value to net realizable value are detailed and justified in the impairment analysis, which is reviewed and approved by our Chief Credit Officer. Although an external appraisal is the primary source to value collateral dependent loans, we may also utilize values obtained through purchase and sale agreements, negotiated short sales, broker price opinions, or the sales price of the note. These alternative sources of value are used only if deemed to be more representative of value based on updated information regarding collateral resolution. Impairment analyses are updated, reviewed and approved on a quarterly basis at or near the end of each reporting period. Based on these processes, we do not believe there are significant time lapses for the recognition of additional provision for loan and lease loss or charge offs from the date they become known.

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Loans are classified as nonaccrual when collection of principal or interest is doubtful; generally these are loans that are past due as to maturity or payment of principal or interest by 90 days or more, unless such loans are well-secured and in the process of collection. Additionally, all loans that are impaired are considered for nonaccrual status. Loans placed on nonaccrual will typically remain on nonaccrual status until all principal and interest payments are brought current and the prospects for future payments in accordance with the loan agreement appear relatively certain.

Upon acquisition of real estate collateral, typically through the foreclosure process, we promptly begin to market the property for sale. If we do not begin to receive offers or indications of interest, we will analyze the price and review market conditions to assess the pricing level that would enable us to sell the property. In addition, we obtain updated appraisals on OREO property every six to twelve months. Increases in valuation adjustments recorded in a period are primarily based on (1) updated appraisals received during the period, or (2) management’s authorization to reduce the selling price of the property during the period. Unless a current appraisal is available, an appraisal will be ordered prior to a loan migrating to OREO. At the time of foreclosure, OREO is recorded at fair value less costs to sell (“cost”), which becomes the property’s new basis. Any write-downs based on the asset’s fair value at the date of acquisition are charged to the ALLL. After foreclosure, management periodically performs valuations and the property is carried at the lower of the cost or fair value less expected selling costs.

The following table summarizes our nonperforming assets as of March 31, 2016 and December 31, 2015.

(Amounts in thousands) **Nonperforming Assets**	**March 31, 2016**	**December 31, 2015**
Commercial	$2,563	$ 1,994
Commercial real estate:		
Real estate - commercial non-owner occupied	1,197	5,488
Real estate - commercial owner occupied	1,190	1,071
Total commercial real estate	2,387	6,559
Residential real estate:		
Real estate - residential - ITIN	3,705	3,649
Real estate - residential - 1-4 family mortgage	1,742	1,775
Real estate - residential - equity lines	1,270	—
Total residential real estate	6,717	5,424
Consumer and other	31	32
Total nonaccrual loans	11,698	14,009

90 days past due and still accruing	—	88
Total nonperforming loans	11,698	14,097
Other real estate owned	1,011	1,423
Total nonperforming assets	$ 12,709	$ 15,520
Nonperforming loans to loans, net of deferred fees and costs	1.61 %	1.96 %
Nonperforming assets to total assets	1.18 %	1.53 %

We are continually performing extensive reviews of the commercial real estate portfolio, including stress testing. These reviews are being performed on both our non-owner and owner occupied credits. These reviews are being completed to verify leasing status, to ensure the accuracy of risk ratings, and to develop proactive action plans with borrowers on projects. Stress testing has been performed to determine the effect of rising cap rates, interest rates, and vacancy rates on the portfolio. Based on our analysis, we believe our lending teams are effectively managing the risks in this portfolio. There can be no assurance that any further declines in economic conditions, such as potential increases in retail or office vacancy rates, will not exceed the projected assumptions utilized in stress testing resulting in additional nonperforming loans in the future.

Loans are reported as troubled debt restructurings when we grant a concession(s) to a borrower experiencing financial difficulties that it would not otherwise consider. Examples of such concessions include a reduction in the loan rate, forgiveness of principal or accrued interest, extending the maturity date(s) significantly, or providing a lower interest rate than would be normally available for a transaction of similar risk. As a result of these concessions, restructured loans are impaired as we will not collect all amounts due, either principal or interest, in accordance with the terms of the original loan agreement. Impairment reserves on non-collateral dependent restructured loans are measured by comparing the present value of expected future cash flows of the restructured loans, discounted at the effective interest rate of the original loan agreement. These impairment reserves are recognized as a specific component to be provided for in the ALLL.

As of March 31, 2016, we had $11.4 million in troubled debt restructurings compared to $15.9 million as of December 31, 2015. As of March 31, 2016, we had 119 restructured loans that qualified as troubled debt restructurings, of which 108 loans were performing according to their restructured terms. Troubled debt restructurings represented 1.58% of gross loans as of March 31, 2016, compared to 2.22% at December 31, 2015.

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At March 31, 2016 and December 31, 2015, impaired loans of $6.9 million and $6.9 million were classified as accruing troubled debt restructurings, respectively. The restructured loans on accrual status represent the majority of impaired loans accruing interest at each respective date. In order for a restructured loan to be on accrual status, the loan’s collateral coverage generally will be greater than or equal to 100% of the loan balance, the loan is current on payments, and the borrower must either prefund an interest reserve or demonstrate the ability to make payments from a verified source of cash flow. We had no obligation to lend additional funds on the restructured loans as of March 31, 2016.

The following table sets forth a summary of our restructured loans that qualify as troubled debt restructurings as of March 31, 2016 and December 31, 2015.

(Amounts in thousands) **Troubled Debt Restructurings**	**March 31, 2016**	**December 31, 2015**
Accruing troubled debt restructurings		
Commercial	$40	$ 49
Commercial real estate:		
Real estate - commercial non-owner occupied	821	824
Real estate - commercial owner occupied	—	—
Residential real estate:		
Real estate - residential - ITIN	5,502	5,458
Real estate - residential - equity lines	553	558
Total accruing troubled debt restructurings	$6,916	$ 6,889
Nonaccruing troubled debt restructurings		
Commercial	$828	$ 863
Commercial real estate:		
Real estate - commercial non-owner occupied	—	4,292
Real estate - commercial owner occupied	1,046	1,071
Residential real estate:		
Real estate - residential - ITIN	2,399	2,538
Real estate - residential - 1-4 family mortgage	212	219
Consumer and other	31	32
Total nonaccruing troubled debt restructurings	$4,516	$ 9,015
Total troubled debt restructurings		
Commercial	$868	$ 912
Commercial real estate:		

Real estate - commercial non-owner occupied	821	5,116
Real estate - commercial owner occupied	1,046	1,071
Residential real estate:		
Real estate - residential - ITIN	7,901	7,996
Real estate - residential - 1-4 family mortgage	212	219
Real estate - residential - equity lines	553	558
Consumer and other	31	32
Total troubled debt restructurings	$11,432	$ 15,904
Total troubled debt restructurings to gross loans outstanding at period end	1.58 %	2.22 %

Allowance for Loan and Lease Losses and Reserve for Unfunded Commitments

The ALLL at March 31, 2016 increased $315 thousand to $11.5 million compared to $11.2 million at December 31, 2015. During the three months ended March 31, 2016 and the year ended December 31, 2015 there were no provisions for loan and lease losses.

We recorded net loan loss recoveries of $315 thousand for the three months ended March 31, 2016 compared to net loan loss recoveries of $360 thousand for the year ended December 31, 2015. The recoveries occurred primarily due to one commercial real estate loan recovery of $528 thousand. During the first three months of 2016, net loan loss recoveries combined with continuing improved asset quality resulted in no provision for loan and lease losses. Our ALLL as a percentage of gross loans was 1.59% and 1.56% as of March 31, 2016 and December 31, 2015, respectively.

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The following table summarizes the activity in the ALLL reserves at March 31, 2016, December 31, 2015 and March 31, 2015

(Amounts in thousands)	**March 31, 2016**	**December 31, 2015**	**March 31, 2015**
Beginning balance ALLL	$11,180	$10,820	$10,820
Provision for loan and lease loss charged to expense	—	—	—
Loans charged off	(307)	(2,376)	(179)
Loan and lease loss recoveries	622	2,736	655
Ending balance ALLL	$11,495	$11,180	$11,296
Nonaccrual loans at period end:			
Commercial	$2,563	$1,994	$3,908
Real estate - commercial non-owner occupied	1,197	5,488	7,103
Real estate - commercial owner occupied	1,190	1,071	1,079
Real estate - residential - ITIN	3,705	3,649	4,645
Real estate - residential - 1-4 family mortgage	1,742	1,775	1,720
Real estate - residential - equity lines	1,270	—	24
Consumer and other	31	32	34
Total nonaccrual loans	11,698	14,009	18,513
Accruing troubled-debt restructured loans:			
Commercial	40	49	1,004
Real estate - commercial non-owner occupied	821	824	836
Real estate - commercial owner occupied	—	—	854
Real estate - residential - ITIN	5,502	5,458	5,421
Real estate - residential - equity lines	553	558	574
Total accruing restructured loans	6,916	6,889	8,689
All other accruing impaired loans	488	492	533
Total impaired loans	$19,102	$21,390	$27,735
Gross loans outstanding at period end	$724,243	$716,639	$649,695
Ratio of ALLL to gross loans outstanding at period end	1.59%	1.56%	1.62%
Nonaccrual loans to gross loans outstanding at period end	1.62%	1.95%	2.65%

As of March 31, 2016, impaired loans totaled $19.1 million, of which $11.7 million were in nonaccrual status. Of the total impaired loans, $9.2 million or 121 were ITIN loans with an average balance of approximately $76 thousand. The remaining impaired loans consist of 12 commercial loans, five commercial real estate loans, six residential mortgages, 11 home equity loans and one consumer loan.

At March 31, 2016, impaired loans had a corresponding valuation allowance of $1.1 million. The valuation allowance on impaired loans represents the impairment reserves on performing restructured loans, other accruing loans, and nonaccrual loans.

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The following table sets forth the allocation of the ALLL and percent of loans in each category to gross loans as of March 31, 2016 and December 31, 2015.

(Amounts in thousands)	**March 31, 2016**			**December 31, 2015**		
ALLL	**Amount**	**% Loan Category**		**Amount**	**% Loan Category**	
Commercial	$2,466	21	%	$2,493	23	%
Commercial real estate:						
Real estate - construction and land development	241	2		246	2	
Real estate - commercial non-owner occupied	3,389	30		3,262	29	
Real estate - commercial owner occupied	2,262	20		2,276	20	
Residential real estate:						
Real estate - residential - ITIN	1,139	10		998	9	
Real estate - residential - 1-4 family mortgage	89	1		93	1	
Real estate - residential - equity lines	733	6		486	4	
Consumer and other	814	7		770	7	
Unallocated	362	3		556	5	
Total ALLL	$11,495	100	%	$11,180	100	%

The unallocated portion of ALLL provides for coverage of credit losses inherent in the loan portfolio but not captured in the credit loss factors that are utilized in the risk grading-based component, or in the specific impairment reserve component of the ALLL, and acknowledges the inherent imprecision of all loss prediction models. As of March 31, 2016, the unallocated allowance amount represented 3% of the ALLL, compared to 5% at December 31, 2015. The ALLL composition should not be interpreted as an indication of specific amounts or loan and lease categories in which future charge offs may occur.

Deposits

Total deposits as of March 31, 2016 were $937.7 million compared to $803.7 million at December 31, 2015, an increase of $134.0 million or 17%. The following table presents the deposit balances by major category as of March 31, 2016, and December 31, 2015.

(Amounts in thousands)	**March 31, 2016**		**December 31, 2015**	
Deposits	**Amount**	**Percentage**	**Amount**	**Percentage**
Noninterest-bearing demand	$212,758	23 %	$169,507	21 %
Interest-bearing demand	178,174	19	165,316	20
Money market accounts	214,151	23	150,342	19
Savings	105,828	11	94,503	12
Certificates of deposit, $100,000 or greater	177,325	19	189,969	24
Certificates of deposit, less than $100,000	49,431	5	34,098	4
Total	$937,667	100 %	$803,735	100 %

The following table sets forth the distribution of our average daily balances and their respective rates as of March 31, 2016, and December 31, 2015.

	March 31, 2016		**December 31, 2015**	
(Amounts in thousands)	**Average Balance**	**Rate**	**Average Balance**	**Rate**
Interest-bearing demand	$156,359	0.14%	$145,106	0.16%
Money market accounts	167,412	0.16%	137,999	0.17%
Savings	96,027	0.19%	92,659	0.23%
Certificates of deposit	221,836	1.08%	238,626	0.99%
Interest-bearing deposits	641,634	0.48%	614,390	0.49%
Noninterest-bearing demand	182,539		156,578	
Average total deposits	$824,173		$770,968	
Term debt [1]	$91,444	3.44%	$88,874	1.98%
Junior subordinated debentures	10,310	2.11%	10,310	1.89%
Average total borrowings	$101,754	3.30%	$99,184	1.97%

[1] Borrowing rate on Federal Home Loan Bank of San Francisco borrowings includes impact of interest rate swaps.

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Deposit Maturity Schedule

The following table sets forth the remaining maturities of certificates of deposit in amounts of $100,000 or more as of March 31, 2016.

(Amounts in thousands) **Maturing in:**	**March 31, 2016**
Three months or less	$26,735
Three through six months	24,724
Six through twelve months	29,001
Over twelve months	96,865
Total	$177,325

We have an agreement with Promontory Interfinancial Network LLC ("Promontory") allowing our Bank to provide FDIC deposit insurance to balances in excess of current FDIC deposit insurance limits. Promontory's Certificate of Deposit Account Registry Service ("CDARS") and Insured Cash Sweep ("ICS") use a deposit-matching program to exchange Bank deposits in excess of the current deposit insurance limits for excess balances at other participating banks, on a dollar-for-dollar basis, that would be fully insured at the Bank. These products are designed to enhance our ability to attract and retain customers and increase deposits, by providing additional FDIC coverage to customers. CDARS and ICS deposits can be reciprocal or one-way; and are considered brokered deposits by the FDIC.

In accordance with regulatory Call Report instructions, we filed quarterly Call Reports, which listed brokered deposits of $61.6 million, and $94.4 million at March 31, 2016 and December 31, 2015, respectively. These amounts include deposits obtained through the CDARS and ICS programs of $61.6 million and $76.9 million, respectively.

During the first quarter of 2016, the branch acquisition provided an additional $149.0 million of deposits and we called and redeemed $17.5 million of brokered certificates of deposit.

Borrowings

Term Debt

At March 31, 2016, we had term debt outstanding with a carrying value of $19.6 million compared to $94.7 million at December 31, 2015. Term debt consisted of the following:

Federal Home Loan Bank of San Francisco borrowings

We utilized a portion of the new liquidity from our branch acquisition to repay $75.0 million to the Federal Home Loan Bank of San Francisco during the first quarter of 2016. Advances from the Federal Home Loan Bank of San Francisco were $75.0 million at December 31, 2015. See Note 10 *Federal Funds Purchased and Lines of Credit* in the *Notes to Consolidated Financial Statements* for information on our Federal Home Loan Bank of San Francisco borrowings and our remaining line of credit.

Senior Debt

In December of 2015, the Holding Company, entered into a senior debt loan agreement to borrow $10.0 million. The debt is secured by a pledge from the Holding Company of all of the outstanding stock of Redding Bank of Commerce. At March 31, 2016, the Senior Debt had a balance of $9.7 million at a variable rate of three month LIBOR plus 400 basis points and matures in 2020.

Subordinated Debt

In December of 2015, the Holding Company issued $10.0 million of fixed to floating rate subordinated notes. The subordinated debt initially bears interest at 6.88% per annum for a five-year term. Thereafter, interest on the subordinated debt will be paid at a variable rate equal to three month LIBOR plus 526 basis points. At March 31, 2016, the Subordinated Debt had a balance of $10.0 million due in 2025.

Corning Lease

In March of 2016, the Bank entered into a capital lease agreement with Bank of America for the branch located in Corning, California. The total obligation under the lease agreement is $172 thousand payable over a four-year period in monthly installments of principal and interest at a 6.0% annual interest rate. The lease may terminate early upon receipt of certification that there are no adverse environmental conditions. Upon termination of the lease agreement, the net present value of the lease becomes due and title will be transferred to the Bank.

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Junior Subordinate Debentures

Bank of Commerce Holdings Trust II

During July 2005, the Holding Company participated in a $10.0 million private placement of fixed rate trust preferred securities (the "Trust Preferred Securities") through a newly formed wholly owned Delaware trust affiliate, Bank of Commerce Holdings Trust II (the "Trust II"). Trust II simultaneously issued $310 thousand common securities to the Holding Company. Rates paid on the Trust Preferred Securities have transitioned from fixed to floating and are now paid on a quarterly basis at three month LIBOR plus 158 basis points. The effective interest rate at March 31, 2016 was 2.21%.

The final maturity on the Trust Preferred Securities is September 15, 2035, and the covenants allow for redemption at the Holding Company's option during any quarter until maturity.

The proceeds from the sale of the Trust Preferred Securities were used by the Trust II to purchase from the Holding Company the aggregate principal amount of $10.3 million of the Holding Company's junior subordinate debentures (the "Notes"). The net proceeds to the Holding Company from the sale of the Notes to the Trust II were partially distributed to the Bank for general corporate purposes, including funding the growth of the Bank's various financial services. The proceeds from the Notes qualify as Tier 1 capital under Federal Reserve Board guidelines.

LIQUIDITY AND CASH FLOW

Redding Bank of Commerce

On March 11, 2016, we completed the purchase of five Bank of America branches located in Northern California. The transaction was attractive to us because it provided a new source of low cost core deposits and allowed us to execute our plan to reconfigure our Balance Sheet. The acquisition provided approximately $142.3 million of new liquidity ($149.0 million of new deposits less payments of $6.7 million made to Bank of America). As we previously announced on March 14, 2016, we utilized a portion of that new liquidity to reduce our reliance on wholesale funding sources, repaying $75.0 million to the Federal Home Loan Bank of San Francisco and redeeming $17.5 million of brokered time deposits. We intend to use the remaining liquidity to fund future loan growth.

The principal objective of our liquidity management program is to maintain our ability to meet the day-to-day cash flow requirements of our customers who either wish to withdraw funds on deposit or to draw upon their credit facilities.

We monitor the sources and uses of funds on a daily basis to maintain an acceptable liquidity position. One source of funds includes public deposits. We may be required to collateralize a portion of public deposits that exceed FDIC insurance limitations based on the state of California’s risk assessment of the Bank. Public deposits represent 2% of total deposits at March 31, 2016 and 3% at December 31, 2015. In addition to liquidity from core deposits, loan repayments and maturities of securities, the Bank can utilize established uncommitted federal funds lines of credit, sell securities, borrow on a secured basis from the Federal Home Loan Bank of San Francisco, borrow from the Federal Reserve Bank, or issue brokered certificates of deposit.

The Bank had the following lines of credit:

Available lines of credit with the Federal Home Loan Bank of San Francisco totaling $297.7 million as of March 31, 2016; credit availability is subject to certain collateral requirements, namely the amount of pledged loans and investment securities.

Available lines of credit with the Federal Reserve Bank totaling $17.5 million subject to collateral requirements, namely the amount of certain pledged loans.

Uncommitted federal funds line of credit agreements with additional financial institutions totaling $40.0 million at March 31, 2016. Availability of lines is subject to federal funds balances available for loan and continued borrower eligibility. These lines are intended to support short-term liquidity needs, and the agreements may restrict consecutive day usage.

Bank of Commerce Holdings

The Holding Company is a separate entity from the Bank and must provide for its own liquidity. Substantially all of the Holding Company's cash flows are obtained from dividends declared and paid by the Bank. There are statutory and regulatory provisions that could limit the ability of the Bank to pay dividends to the Holding Company. As of January 1, 2016, the California Financial Code requires the Bank to obtain regulatory approval for any one dividend or other distribution to the Holding Company exceeding $387 thousand. During 2016, management does not anticipate needing to obtain prior regulatory approval from the California Department of Business Oversight. We believe that such restrictions will not have an adverse impact on the ability of the Holding Company to fund its quarterly cash dividend distributions to common shareholders or to meet its ongoing cash obligations, which consist principally of debt service on junior subordinated debentures and term debt.

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

Consolidated Statements of Cash Flows

As disclosed in the *Consolidated Statements of Cash Flows*, net cash of $8.1 million was provided by operating activities for the three months ended March 31, 2016. The material differences between cash provided by operating activities and net income consisted of: $2.3 million in loss on the cancellation of interest rate swap and $5.4 million owed to Bank of America as part of the final acquisition settlement accounting. Non-cash items including depreciation, amortization and increased deferred tax assets were $1.2 million.

Net cash of $117.1 million provided by investing activities consisted principally of $142.3 million from the acquisition of Bank of America branches and $5.5 million in proceeds from maturities and payments of available-for-sale securities partially offset by $2.6 million in payments to derivative counterparties for the termination of interest rate swaps, $20.4 million in net purchases of available-for-sale investment securities and $7.2 million in net loan purchases and originations.

Net cash of $90.7 million used for financing activities consisted principally of $75.3 million in net repayment of term debt and $21.5 million decrease in certificates of deposit.

CAPITAL RESOURCES

We use capital to support organic growth and pay dividends. The objective of effective capital management is to produce above market long term returns by using capital when returns are perceived to be high and issuing capital when costs are perceived to be low. Our potential sources of capital include retained earnings, common and preferred stock issuance, and issuance of subordinated debt, senior debt or trust notes.

Overall capital adequacy is monitored on a day-to-day basis by management and reported to our Board of Directors on a monthly basis. Our regulators measure capital adequacy by using a risk-based capital framework and by monitoring compliance with minimum leverage ratio guidelines. Under the risk-based capital standard, assets reported on our *Consolidated Balance Sheets* and certain off-balance sheet items are assigned to risk categories, each of which is assigned a risk weight.

This standard characterizes an institution's capital as being "Tier 1" capital (defined as principally comprising shareholders' equity) and "Tier 2" capital (defined as principally comprising the qualifying portion of the ALLL). The minimum ratio of total risk-based capital to risk-adjusted assets, including certain off-balance sheet items, is 8%. At least one-half (4%) of the total risk-based capital is to be comprised of common equity; the remaining balance may consist of debt securities and a limited portion of the ALLL.

Quantitative measures established by regulation to ensure capital adequacy require the Holding Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets and of Tier 1 capital to average assets. Management believes that the Holding Company and the Bank met all capital adequacy requirements to which they are subject, as of March 31, 2016.

On July 2, 2013, the federal banking agencies substantially amended the regulatory risk-based capital rules applicable to the Holding Company and the Bank. Effective January 1, 2015, the new rules create "Tier 1 Common Equity," a new measure of regulatory capital closer to pure tangible common equity than the present Tier 1 definition; The required minimum risk-based capital ratio for Tier 1 Common Equity is 4.5 percent and with a 2.5 percent capital conservation buffer.

The new capital rules require the Bank to meet the capital conservation buffer requirement by 2019 in order to avoid constraints on capital distributions, such as dividends and equity repurchases, and certain bonus compensation for executive officers. These new capital rules also change the risk-weights of certain assets for purposes of the risk-based capital ratios and phases out certain instruments as qualifying capital. Based on management's review and analysis of Basel III, management believes that the Holding Company and the Bank will remain in excess of the "well-capitalized" standards under these new rules.

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As of March 31, 2016, the most recent notification from the FDIC categorized the Bank as “well capitalized” under the regulatory framework for prompt corrective action. There are no conditions or events since the notification that management believes have changed the Bank’s category. The Holding Company and the Bank’s capital amounts and ratios as of March 31, 2016, are presented in the following table.

(Amounts in thousands)	**Capital**	**Actual Ratio**		**Well Capitalized Requirement**		**Minimum Capital Requirement**	
Holding Company:							
Common equity tier 1 capital ratio	$87,709	9.82	%	n/a		4.50	%
Tier 1 capital ratio	$97,676	10.93	%	n/a		6.00	%
Total capital ratio	$118,857	13.30	%	n/a		8.00	%
Tier 1 leverage ratio	$97,676	9.48	%	n/a		4.00	%
Bank:							
Common equity tier 1 capital ratio	$116,719	13.07	%	6.50	%	4.50	%
Tier 1 capital ratio	$116,719	13.07	%	8.00	%	6.00	%
Total capital ratio	$127,896	14.32	%	10.00	%	8.00	%
Tier 1 leverage ratio	$116,719	11.36	%	5.00	%	4.00	%

Total shareholders’ equity at March 31, 2016 was $90.7 million, compared to shareholder’s equity of $90.5 million reported at December 31, 2015.

As part of the branch acquisition, we recorded a core deposit intangible of $1.8 million and goodwill of $717 thousand. When calculating capital ratios, goodwill and a portion of core deposit intangibles are subtracted from Tier 1 capital. The deduction for core deposit intangibles is subject to a phase in period under the Basel III risk based capital rules. During 2016, 60% of the core deposit intangible will be deducted from Tier 1 capital, 80% for 2017 and 100% thereafter. Both of these intangible assets are subtracted from tangible equity as part of the calculation of tangible book value per share.

Cash Dividends and Payout Ratios per Common Share

During the three months ended March 31, 2016 and 2015, we declared a quarterly cash dividend of $0.03 per common share. These dividends were made pursuant to our existing dividend policy and in consideration of, among other things, earnings, regulatory capital levels, capital preservation, expected growth, and the overall payout ratio. We expect that the dividend rate will be reassessed periodically by the Board of Directors in accordance with the dividend policy. There is no assurance that future cash dividends on common shares will be declared or increased.

The following table presents cash dividends declared and dividend payout ratios (dividends declared per common share divided by basic earnings per common share) for the three months ended March 31, 2016 and 2015.

	Three Months Ended March 31,	
	2016	**2015**
Dividends declared per common share	$0.03	$0.03
Dividend payout ratio	(42)%	23 %

OFF-BALANCE SHEET ARRANGEMENTS

Information regarding Off-Balance Sheet Arrangements is included in Note 12, *Commitments and Contingencies,* in the *Notes to Consolidated Financial Statements* incorporated in this document.

CONCENTRATION OF CREDIT RISK

Information regarding Concentration of Credit Risk is included in Note 12, *Commitments and Contingencies,* in the *Notes to Consolidated Financial Statements* incorporated in this document.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our assessment of market risk as of March 31, 2016 indicates there are no material changes in the quantitative and qualitative disclosures from those in our Annual Report on Form 10-K for the year ended December 31, 2015.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of the Company’s management, including its President and Chief Executive Officer and its Chief Financial Officer, of the effectiveness of its disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based on that evaluation, the President and Chief Executive Officer and the Chief Financial Officer concluded that these disclosure controls and procedures were effective.

Disclosure controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving an entity’s disclosure objectives. The likelihood of achieving such objectives is affected by limitations inherent in disclosure controls and procedures. These include the fact that human judgment in decision-making can be faulty and that breakdowns in internal controls can occur because of human failures such as simple errors, mistakes or intentional circumvention of the established processes.

Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed by, or under the supervision of, the Company’s Chief Executive Officer and the Chief Financial Officer and implemented by the Company’s Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles in the United States of America.

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

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

On a quarterly basis, we carry out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Principal Financial Officer (whom is also our Principal Accounting Officer) of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934. As of March 31, 2016, our management, including our Chief Executive Officer, and Principal Financial Officer, concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to us that is required to be included in our periodic SEC filings.

Although we change and improve our internal controls over financial reporting on an ongoing basis, we do not believe that any such changes occurred in the first three months of 2016 that materially affected or are reasonably likely to materially affect our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are subject to various pending and threatened legal actions arising in the ordinary course of business and maintains reserves for losses from legal actions that are both probable and estimable. There are no legal proceedings adverse to the Company that will have a material effect on our consolidated financial position or results of operations.

Item 1a. Risk Factors

There have been no significant changes in the risk factors previously disclosed in the Company's Form 10-K for the period ended December 31, 2015, filed with the SEC on March 8, 2016.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

a) Not Applicable

b) Not Applicable

c) Not Applicable

Item 3. Defaults Upon Senior Securities

Not Applicable

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

Not Applicable

Item 6. Exhibits

31.1	Certification of Chief Executive Officer pursuant to Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Sarbanes-Oxley Act of 2002
32.0	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Definition Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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SIGNATURES

Following the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BANK OF COMMERCE HOLDINGS

(Registrant)

Date: May 6, 2016	*/s/ James A Sundquist* James A. Sundquist Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)