

UNITED SECURITY BANCSHARES
Form 10-K
March 16, 2007

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-K

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006.
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____
Commission file number: 000-32987

UNITED SECURITY BANCSHARES

(Exact name of registrant as specified in its charter)

CALIFORNIA

91-2112732

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

1525 East Shaw Ave., Fresno, California

93710

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code (559) 248-4943

Securities registered pursuant to Section 12(b) of the Act: Common Stock, no par value on Nasdaq

(Title of Class)

Securities registered pursuant to Section 12(g) of the Act: NONE

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

Yes No

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

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing for the past 90 days.

Yes No

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

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Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Yes No

Aggregate market value of the Common Stock held by non-affiliates as of the last business day of the registrant's most recently completed second fiscal quarter - June 30, 2006: \$176,056,726

Shares outstanding as of February 28, 2007: 12,263,126

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the Definitive Proxy Statement for the 2007 Meeting of Shareholders is incorporated by reference into Part III.

Part III, Items 10, 11, 12, 13 and 14

UNITED SECURITY BANCSHARES

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PART 1

Certain matters discussed or incorporated by reference in this Annual Report of Form 10-K including, but not limited to, those described in Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations, are forward-looking statements as defined under the Securities Litigation Reform Act of 1995 that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Such risks and uncertainties include, among others, (1) competitive pressure in the banking industry increases significantly; (2) changes in the interest rate environment which may reduce margins and devalue assets; (3) general economic conditions, either nationally or regionally, are less favorable than expected, resulting in, among other things, a deterioration in credit quality; (4) changes in the regulatory environment; (5) changes in business conditions and inflation; (6) changes in securities markets; (7) asset/liability matching risks and liquidity risks; (8) loss of key personnel; and (9) operational interruptions including data processing systems failure and fraud. Therefore, the information set forth therein should be carefully considered when evaluating the business prospects of the Company.

Item 1 - Business

General

United Security Bancshares (the Company) is a California corporation incorporated during March of 2001 and is registered with the Board of Governors of the Federal Reserve System as a bank holding company under the Bank Holding Company Act of 1956, as amended. The Company's stock is listed on NASDAQ under the symbol UBFO. United Security Bank (the Bank) is a wholly-owned bank subsidiary of the Company and was formed in 1987. United Security Bancshares Capital Trust I (the Trust) was formed during June of 2001 as a Delaware business trust for the sole purpose of issuing Trust Preferred securities. The Trust was originally formed as a subsidiary of the Company, but was deconsolidated during 2004 pursuant to the adoption of FIN 46 (as revised), Consolidation of Variable Interest Entities. At present, the Company does not engage in any material business activities other than ownership of the Bank.

United Security Bank

On June 12, 2001, the Bank became the wholly owned subsidiary of United Security Bancshares, through a tax-free holding company reorganization, accounted for on a basis similar to the pooling of interest method. In the transaction, each share of Bank stock was exchanged for a share of Company stock on a one-to-one basis.

The Bank is a California state-chartered bank headquartered in Fresno, California. It is also a member of the Federal Reserve System (Fed member). The Bank originally commenced business on December 21, 1987 as a national bank and, during the fourth quarter of 1998, filed an application with the California Department of Financial Institutions and other regulatory authorities to become a state-chartered bank. The shareholders approved the conversion in January of 1999, and the Bank was granted approval to operate as a state-chartered bank on February 3, 1999. The Bank's operations are currently subject to federal and state laws applicable to state-chartered, Fed member banks and its deposits are insured up to the applicable limits by the Federal Deposit Insurance Corporation (the FDIC). The Bank is also subject to the Federal Deposit Insurance Act and regulatory reporting requirements of the FDIC. As a state-chartered bank and a member of the Federal Reserve System, the Bank is subject to supervision and regular examinations by the Board of Governors of the Federal Reserve System (the FRB) and the California Department of Financial Institutions (the DFI). In addition, the Bank is required to file reports with the FRB and provide such additional information as the FRB may require.

Effective August 25, 1995, the Bank consummated a merger with Golden Oak Bank, a two branch California state chartered bank located in Oakhurst, California, with assets of approximately \$45 million at the date of merger. The merger was accounted for as a pooling of interests.

During February of 1997, the Bank completed the purchase of the deposits and certain assets of two branches of Wells Fargo Bank located in Caruthers and San Joaquin, both located in Fresno County. This brought the total branches operated at that time by the Bank to six and the total assets to approximately \$190 million. The Bank paid a premium of approximately \$1.2 million to purchase deposit accounts totaling approximately \$33.4 million. The Bank also purchased cash balances as well as certain fixed assets of the branch operations.

During October of 1997, the Bank completed the purchase from Bank of America of two of its branches located in Firebaugh and Coalinga, both located in Fresno County. The acquisition brought the total branches operated by the Bank to eight at that time and the total assets to approximately \$238 million. The premium paid by the Bank totaled approximately \$3.0 million and the amount of deposits totaled approximately \$44.4 million. The transaction included the receipt of cash balances of approximately \$1.0 million and the purchase of premises and equipment totaling approximately \$600,000.

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USB Investment Trust Inc. was incorporated effective December 31, 2001 as a special purpose real estate investment trust (REIT) under Maryland law. The REIT is a subsidiary of the Bank and was funded with \$133.0 million in real estate-secured loans contributed by the Bank. USB Investment Trust was originally formed to give the Bank flexibility in raising capital, and reduce the expenses associated with holding the assets contributed to USB Investment Trust. For further discussion of the REIT, refer to Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Income Taxes.

Effective April 23, 2004, the Company completed a merger with Taft National Bank headquartered in Taft, California. Taft National Bank (Taft) was merged into United Security Bank and Taft's two branches operate as branches of United Security Bank. The total consideration paid to Taft shareholders was 241,447 shares of the Company's Common Stock valued at just over \$6 million. In the merger, the Company acquired \$15.4 million in cash and short-term investments, \$23.3 million in loans, and \$48.2 million in deposits. This transaction was accounted for using the purchase method of accounting, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Taft based on the fair value of those assets and liabilities. The consolidated statement of income for the year ended December 31, 2004 includes the operations of Taft from the date of the acquisition to December 31, 2004.

On October 6, 2006 the Company announced the signing of a definitive merger agreement providing for the merger of Legacy Bank, N.A. with and into United Security Bank, a wholly owned subsidiary of the Company. Legacy Bank operates one banking office in Campbell, California serving small business and retail banking clients. The merger was completed February 16, 2007 and after that date, Legacy Bank's branch office began operating as a branch office of United Security Bank. As of February 16, 2007, Legacy Bank had total assets of \$78.5 million and deposits of \$69.6 million. (See Note 22 to the Company's consolidated financial statements contained herein for details of the merger).

At December 31, 2006, the Company operated ten full-service bank branches and one construction lending office; with seven branches in Fresno County, two branches in Kern County, and one branch in Madera County. The Bank operates three branches (including its main office) and one construction lending office in Fresno and one branch each, in Oakhurst, Caruthers, San Joaquin, Firebaugh, Coalinga, Bakersfield, and Taft. In addition, the Company and Bank have administrative headquarters, which were relocated during November 2006 to 2126 Inyo Street, Fresno, California, 93721.

At December 31, 2006, the consolidated Company had approximately \$678.3 million in total assets, \$491.2 million in net loans, \$587.1 million in deposits, and \$66.0 million in shareholders' equity.

The following discussion of the Company's services should be read in conjunction with MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Bank Services

As a state-chartered commercial bank, United Security Bank offers a full range of commercial banking services primarily to the business and professional community and individuals located in Fresno, Madera, and Kern Counties. The Bank will also offer a full range of banking services in Santa Clara County with its recent purchase of Legacy Bank in Campbell, California.

The Bank offers a wide range of deposit instruments including personal and business checking accounts and savings accounts, interest-bearing negotiable order of withdrawal (NOW) accounts, money market accounts and time certificates of deposit. Most of the Bank's deposits are attracted from individuals and from small and medium-sized business-related sources.

The Bank also engages in a full complement of lending activities, including real estate mortgage, commercial and industrial, real estate construction, as well as agricultural, lease financing, and consumer loans, with particular emphasis on short and medium-term obligations. The Bank's loan portfolio is not concentrated in any one industry, although approximately 60% of the Bank's loans are secured by real estate. A loan may be secured (in whole or in part) by real estate even though the purpose of the loan is not to facilitate the purchase or development of real estate. At December 31, 2006, the Bank had loans (net of unearned fees) outstanding of \$499.6 million, which represented approximately 85% of the Bank's total deposits and approximately 74% of its total assets.

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Real estate mortgage loans are secured by deeds of trust primarily on commercial property. Repayment of real estate mortgage loans is generally from the cash flow of the borrower. Commercial and industrial loans have a high degree of industry diversification. Loans may be originated in the Company's market area, or participated with other financial institutions outside the Company's market area. A substantial portion of commercial and industrial loans are secured by accounts receivable, inventory, leases or other collateral. The remainder are unsecured; however extensions of credit are predicated on the financial capacity of the borrower to repay the extension of credit. Repayment of commercial loans is generally from the cash flow of the borrower. Real estate construction loans consist of loans to residential contractors, which are secured by single-family residential properties. All real estate loans have established equity requirements. Repayment of real estate construction loans is generally from long-term mortgages with other lending institutions. Agricultural loans are generally secured by land, equipment, inventory and receivables. Repayment of agricultural loans is from the expected cash flow of the borrower.

In the normal course of business, the Bank makes various loan commitments and incurs certain contingent liabilities. At December 31, 2006 and 2005, loan commitments and letters of credit of the Bank aggregated \$193.1 million and \$197.8 million, respectively. Of the \$193.1 million in loan commitments outstanding at December 31, 2006, \$165.0 million or 85 % were for loans with maturities of one year or less. Due to the nature of the business of the Bank's customers, there are no seasonal patterns or absolute predictability to the utilization of unused loan commitments; therefore the Bank is unable to forecast the extent to which these commitments will be exercised within the current year. The Bank does not believe that any such utilization will constitute a material liquidity demand.

In addition to the loan and deposit services discussed above, the Bank also offers a wide range of specialized services designed to attract and service the needs of commercial customers and account holders. These services include online banking, safe deposit boxes, ATM services, payroll direct deposit, cashier's checks, traveler's checks, money orders, and foreign drafts. The Bank does not operate a trust department; however, it makes arrangements with its correspondent bank to offer trust services to its customers on request. Most of the Bank's business originates within Fresno, Madera, and Kern Counties. Neither the Bank's business or liquidity is seasonal, and there has been no material effect upon the Bank's capital expenditures, earnings or competitive position as a result of federal, state or local environmental regulation.

Competition and Market Share

The banking business in California generally, and in the market area served by the Company specifically, is highly competitive with respect to both loans and deposits. The Company competes for loans and deposits with other commercial banks, savings and loan associations, finance companies, money market funds, credit unions and other financial institutions, including a number that are substantially larger than the Company. Deregulation of the banking industry, increased competition from non-bank entities for the cash balances of individuals and businesses, and continuing developments in the computer and communications industries have had, and most likely will continue to have, a significant impact on the Company's competitive position. With the enactment of interstate banking legislation in California, bank holding companies headquartered outside of California will continue to enter the California market and provide competition for the Company. Additionally, with the Gramm-Leach-Bliley Act of 1999, traditional competitive barriers between insurance companies, securities underwriters, and commercial banks have been eased, allowing a greater number of financial intermediaries to offer a wider assortment of financial services. Many of the major commercial banks operating in the Company's market areas offer certain services such as trust and international banking services, which the Company does not offer directly. In addition, banks with larger capitalization have larger lending limits and are thereby able to serve larger customers.

The Company's primary market area at December 31, 2006 was located in Fresno, Madera, and Kern Counties, in which approximately 32 FDIC-insured financial institutions compete for business. Santa Clara County has been added during 2007 with the Legacy Bank acquisition, in which approximately 52 FDIC-insured financial institutions compete for business. The following table sets forth information regarding deposit market share and ranking by county as of June 30, 2006, which is the most current information available.

	<u>Rank</u>	<u>Share</u>
Fresno County	8 th	5.06%
Madera County	8 th	4.49%
Kern County	13 th	1.20%
Total of Fresno, Madera, Kern Counties	9 th	3.65%
Santa Clara County	30 th	0.14%

Supervision and Regulation

The Company

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the BHC Act), and is registered as such with the FRB. A bank holding company is required to file with the FRB annual reports and other information regarding its business operations and those of its subsidiaries and is also subject to examination by the FRB.

The BHC Act requires, among other things, prior approval before acquiring, directly or indirectly, ownership or control of any voting shares of any bank, if after such acquisition it would directly or indirectly own or control more than 5% of the voting stock of that bank, unless it already owns a majority of the voting stock of that bank. The BHC Act also provides that the FRB shall not approve any acquisition that would result in or further the creation of a monopoly, or the effect of which may be substantially to lessen competition, unless the anticompetitive effects of the proposed transaction are clearly outweighed by the probable effect in meeting the convenience and needs of the community served.

Furthermore, under the BHC Act, a bank holding company is, with limited exceptions, prohibited from (i) acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or (ii) engaging in any activity other than managing or controlling banks. With the prior approval of the FRB, however, a bank holding company may own shares of a company engaged in activities which the FRB has determined to be so closely related to banking or managing or controlling banks as to be proper incident thereto.

The BHC Act requires a bank holding company to serve as a source of financial and managerial strength to its subsidiary banks. It is the FRB's policy that a bank holding company should stand ready to use available resources to provide adequate capital funds to subsidiary banks during periods of financial stress and should maintain the financial flexibility and capital raising capacity to obtain additional resources for assisting a subsidiary bank. Under certain conditions, the FRB may conclude that certain actions of a bank holding company, such as payment of cash dividends, would constitute unsafe and unsound banking practices because they violate the FRB's source of strength doctrine.

A bank holding company and its subsidiaries are prohibited from certain tie-in arrangements in connection with any extension of credit, sale or lease of property or furnishing of services. For example, with certain exceptions, a bank may not condition an extension of credit on a promise by its customer to obtain other services by it, its holding company or other subsidiaries, or on a promise by its customer not to obtain services from a competitor. In addition, federal law imposes certain restrictions between the Company and its subsidiaries, including the Bank. As an affiliate of the Bank, the Company is subject, with certain exceptions, to provisions of federal law imposing limitations on, and requiring collateral for, extensions of credit by the Bank to its affiliates.

In 1999 the Gramm-Leach-Bliley Act (the GLBA) was enacted. The GLBA became effective in March of 2000 and is a financial services modernization law that, among other things, facilitates broad new affiliations among securities firms, insurance companies and bank holding companies by repealing the 66-year old provisions of the Glass-Steagall Act. The GLBA allows the formation of financial holding companies (FHCs), which are bank holding companies with substantially expanded powers. A bank holding company must acquire the approval of the FRB to become a FHC. Under these expanded powers, affiliations may occur between bank holding companies, securities firms and insurance companies, subject to a blend of umbrella supervision and regulation of the newly formed consolidated entity by the Federal Reserve, oversight of the FHC's bank and thrift subsidiaries by their primary federal and state banking regulators and financial regulation of the FHC's nonbank subsidiaries by their respective specialized regulators. The Company has not applied to become a FHC.

As a public company, United Security Bancshares is subject to the Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act amends the Securities and Exchange Act of 1934, and is intended to protect investors by, among other things, improving the reliability of financial reporting, increasing management accountability, and increasing the independence of Directors and the Company's external accountants (see *Recent Legislation and Other Changes*).

The Company is subject to the periodic reporting requirements of the Securities Exchange Act of 1934, as amended, which include but are not limited to the filing of annual, quarterly and other current reports with the SEC.

The Bank

The Bank as a state-chartered bank is subject to regulation, supervision and regular examination by the California Department of Financial Institutions. In addition, The Bank is also a member of the Federal Reserve System and, as such, is subject to applicable provisions of the Federal Reserve Act and regulations issued thereunder and, is subject to regulation, supervision and regular examination by the Federal Reserve Bank. The Bank is subject to California law, insofar as they are not preempted by federal banking law. Deposits of the Bank are insured by the FDIC up to the applicable limits in an amount up to \$100,000 per customer, and, as such, the Bank is subject to the regulations of the FDIC and the Federal Deposit Insurance Act. As a consequence of the extensive regulation of commercial banking activities in California and the United

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States, the Bank's business is particularly susceptible to changes in California and federal legislation and regulation, which may have the effect of increasing the cost of doing business, limiting permissible activities or increasing competition.

Various other requirements and restrictions under the laws of the United States and the State of California affect the operations of the Bank. Federal and California statutes and regulations relate to many aspects of the Bank's operations, including capital requirements and disclosure requirements to depositors and borrowers, requirements to maintain reserves against deposits, limitations on interest rates payable on deposits, loans, investments, and restrictions on borrowings and on payment of dividends. The DFI regulates the number and location of branch offices of a state-chartered bank, and may permit a bank to maintain branches only to the extent allowable under state law for state banks. California law presently permits a bank to locate a branch in any locality in the state. Additionally, California law exempts banks from California usury laws.

Effect of Governmental Policies and Recent Legislation

Banking has traditionally been a business that depends on rate differentials. In general, the difference between the interest rate paid by the Company on its deposits and other borrowings and the interest rate received on loans extended to its customers and securities held in the Company's portfolio comprise the major portion of the Company's earnings. These rates are highly sensitive to many factors which are beyond the control of the Company. Accordingly, the earnings and growth of the Company are subject to the influence of domestic and foreign economic conditions, including, but not limited to, inflation, recession and unemployment.

The earnings and growth of the Company are affected not only by general economic conditions, both domestic and foreign, but also by the monetary and fiscal policies of the United States government and its agencies, particularly the Federal Reserve Board (FRB). The FRB implements national monetary policies (with objectives such as to curb inflation and combat recession) by its open market operations in United States Government securities, by adjusting the required level of reserves for financial institutions subject to reserve requirements, and by varying the discount rates applicable to borrowing by banks which are members of the Federal Reserve System. The actions of the FRB in these areas influence the growth of bank loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. The nature and impact that future changes in fiscal or monetary policies or economic controls may have on the Company's business and earnings cannot be predicted. In addition, adverse economic conditions could make a higher provision for loan losses a prudent course and could cause higher loan charge-offs, thus adversely affecting the Company's net income.

From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial institutions. Proposals to change the laws and regulations governing the operations and taxation of banks and other financial institutions are frequently made in Congress, in the California legislature and before various bank regulatory agencies. The likelihood of any major change and the impact such change may have on the Company is impossible to predict. Certain of the potentially significant changes which have been enacted recently and other which are currently under consideration by Congress or various regulatory agencies or professional agencies are discussed below.

Recent Legislation and Other Changes

Federal and state laws affecting banking are enacted from time to time, and similarly federal and state regulations affecting banking are also adopted from time to time. The following include some of the recent laws and regulations affecting banking.

On February 8, 2006, the President signed The Federal Deposit Insurance Reform Act of 2005 (the Reform Act) into law. The Federal Deposit Insurance Reform Conforming Amendments Act of 2005, which the President signed into law on February 15, 2006, contains necessary technical and conforming changes to implement deposit insurance reform, as well as a number of study and survey requirements. The Reform Act provides for the following changes:

Merging the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) into a new fund, the Deposit Insurance Fund (DIF). This change was made effective March 31, 2006.

Increasing the coverage limit for retirement accounts to \$250,000 and indexing the coverage limit for retirement accounts to inflation as with the general deposit insurance coverage limit. This change was made effective April 1, 2006.

Establishing a range of 1.15 percent to 1.50 percent within which the FDIC Board of Directors may set the Designated Reserve Ratio (DRR).

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Allowing the FDIC to manage the pace at which the reserve ratio varies within this range.

1. If the reserve ratio falls below 1.15 percent or is expected to within 6 months the FDIC must adopt a restoration plan that provides that the DIF will return to 1.15 percent generally within 5 years.
2. If the reserve ratio exceeds 1.35 percent, the FDIC must generally dividend to DIF members half of the amount above the amount necessary to maintain the DIF at 1.35 percent, unless the FDIC Board, considering statutory factors, suspends the dividends.
3. If the reserve ratio exceeds 1.5 percent, the FDIC must generally dividend to DIF members all amounts above the amount necessary to maintain the DIF at 1.5 percent.

Eliminating the restrictions on premium rates based on the DRR and granting the FDIC Board the discretion to price deposit insurance according to risk for all insured institutions regardless of the level of the reserve ratio.

Granting a one-time initial assessment credit (of approximately \$4.7 billion) to recognize institutions' past contributions to the fund.

The Federal Reserve Board in February 2006 approved a final rule that expands the definition of a small bank holding company under its Small Bank Holding Company Policy Statement and the Board's risk-based and leverage capital guidelines for bank holding companies. The policy statement facilitates the transfer of ownership of small community banks by permitting debt levels at small bank holding companies that are higher than what would typically be permitted for larger small bank holding companies. In its revisions to the Policy Statement, the Federal Reserve Board has raised the small bank holding company asset size threshold from \$150 million to \$500 million and amended the related qualitative criteria for determining eligibility as a small bank holding company for the purposes of the policy statement and the capital guidelines.

The FDIC finalized its interim final rule, with changes, that amended its deposit insurance regulations to implement applicable revisions to the Federal Deposit Insurance Act made by the Federal Deposit Insurance Reform Act of 2005 and the Federal Deposit Insurance Reform Conforming Amendments Act of 2005. The final rule provides for consideration of inflation adjustments to increase the current standard maximum deposit insurance amount of \$100,000 on a five-year cycle beginning in 2010; increases the deposit insurance limit for certain retirement accounts from \$100,000 to \$250,000, also subject to inflation adjustments; and provides per-participant insurance coverage to employee benefit plan accounts, even if the depository institution at which the deposits are placed is not authorized to accept employee benefit plan deposits. The final rule is effective on October 12, 2006.

The Board of Governors of the Federal Reserve System amended Regulation E, which implements the Electronic Fund Transfer Act, and the official staff commentary to the regulation, which interprets the requirements of Regulation E to become effective on July 1, 2006. The final rule provides that Regulation E covers payroll card accounts that are established directly or indirectly through an employer, and to which transfers of the consumer's salary, wages, or other employee compensation are made on a recurring basis. The final rule also provides financial institutions with an alternative to providing periodic statements for payroll card accounts if they make account information available to consumers by specified means.

The federal financial regulatory agencies in September 2006 issued final guidance to address the risks posed by nontraditional residential mortgage products that allow borrowers to defer repayment of principal and sometimes interest, including interest-only mortgages and payment option adjustable-rate mortgages. These products allow borrowers to exchange lower payments during an initial period for higher payments later. The lack of principal amortization and the potential for negative amortization and features that compound risks (such as no document loans and simultaneous second mortgages) elevate the concern of the federal banking agencies for nontraditional mortgage products. The guidelines require depository institutions to ensure that loan terms and underwriting standards are consistent with prudent lending practices, including consideration of a borrower's repayment capacity, to recognize that many nontraditional mortgage loans, particularly when they have risk-layering features, are untested in a stressed environment. The guidelines also express the need for depository institutions to have strong risk management standards, capital levels commensurate with the risk, an allowance for loan and lease losses that reflects the collectibility of the portfolio, and the need to make sure that consumers have sufficient information to clearly understand loan terms and associated risks prior to making a product or payment choice.

The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation in December 2006 issued final guidance on sound risk management practices for concentrations in commercial real estate lending. The agencies observed that the commercial real estate is an area in which some banks are becoming increasingly concentrated, especially with small- to medium- sized banks that face strong competition in their other business lines. The agencies support banks serving a vital role in their communities by supplying credit for business and real estate development. However, the agencies are concerned that rising commercial real estate loan concentrations may expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in commercial real estate markets. The guidance provides supervisory criteria, including numerical indicators to assist in identifying institutions with potentially significant commercial real estate loan concentrations that may warrant greater supervisory scrutiny, but such criteria are not limits

on commercial real estate lending.

The federal financial regulatory agencies in December 2006 issued a new interagency policy statement on the allowance for loan and lease losses (ALLL) along with supplemental frequently asked questions. The policy statement revises and replaces a 1993 policy statement on the ALLL. The agencies issued the revised policy statement in view of today's uncertain economic environment and the presence of concentrations in untested loan products in the loan portfolios of insured depository institutions. The policy statement has also been revised to conform to generally accepted accounting principles (GAAP) and post-1993 supervisory guidance. The 1993 policy statement described the responsibilities of the boards of directors, management, and banking examiners regarding the ALLL; factors to be considered in the estimation of the ALLL; and the objectives and elements of an effective loan review system, including a sound credit grading system. The policy statement reiterates that each institution has a responsibility for developing, maintaining and documenting a comprehensive, systematic, and consistently applied process appropriate to its size and the nature, scope, and risk of its lending activities for determining the amounts of the ALLL and the provision for loan and lease losses and states that each institution should ensure controls are in place to consistently determine the ALLL in accordance with GAAP, the institution's stated policies and procedures, management's best judgment and relevant supervisory guidance.

The policy statement also restates that insured depository institutions must maintain an ALLL at a level that is appropriate to cover estimated credit losses on individually evaluated loans determined to be impaired as well as estimated credit losses inherent in the remainder of the loan and lease portfolio, and that estimates of credit losses should reflect consideration of all significant factors that affect the collectibility of the portfolio as of the evaluation date. The policy statement states that prudent, conservative, but not excessive, loan loss allowances that represent management's best estimate from within an acceptable range of estimated losses are appropriate.

In California, effective January 1, 2007, a new law Financial Code Section 854.1 recognizes the ability of mortgage brokers to obtain the benefit of non interest-bearing accounts on trust funds deposited in a commercial bank. The provision applies to real estate brokers who collect payments or provide services in connection with a loan secured by a lien on real property and permits a mortgage broker to earn interest on an interest-bearing account at a financial institution. Interest on funds received by a real estate broker who collects payments or provides services for an institutional investor in connection with a loan secured by commercial real property may inure to the broker, if agreed to in writing by the broker and the institutional investor. For purposes of this law, commercial real property means real estate improved with other than a one-to-four family residence.

A new California law makes it easier for California banks to accept deposits from local government agencies. Under the old law, local agency deposits over \$100,000 had to be secured by collateral. Pursuant to the enactment of Assembly Bill 2011, banks would be able to acquire surplus public deposits exceeding \$100,000 without pledging collateral if they participate in a deposit placement service where excess amounts are placed in certificates of deposit at other institutions within a network. Such a network (of which currently there is only one available in the market) permits the entire amount of a customer's deposit to be FDIC-insured, and the bank taking the original deposit retains the benefit of the full amount of the deposit for lending or other purposes. AB 2011 clarifies that a local agency may deposit up to 30% of its surplus funds in certificates of deposit at a bank, savings association, savings bank, or credit union that participates in such a deposit-sharing network. Since the entire amount of the deposits would be FDIC-insured, a bank would not be required to pledge collateral. The bill permits agencies to make these deposits until January 1, 2012.

The Federal Reserve Board in November 2005 approved amendments to Regulation CC that define remotely created checks and create transfer and presentment warranties that shift liability for an unauthorized remotely created check to the institution where it is first deposited. In place of a signature, a remotely created check generally bears a statement that the customer authorized the check or bears the customer's printed or typed name, such as when a debtor authorizes a credit card company to create a remotely created check by telephone so that the debtor may pay a credit card bill in a timely manner. Since the remotely created checks are vulnerable to fraud Regulation CC creates transfer and presentment warranties under which any bank that transfers or presents a remotely created check would warrant that the check is authorized by the person on whose account the check is drawn. The warranties would apply only to banks and would ultimately shift liability for losses attributable to an unauthorized remotely created check to the depository bank. These amendments would not affect the rights of checking account customers, as they are not liable for unauthorized checks drawn on their accounts. The amendments to Regulation CC become effective on July 1, 2006.

On August 2, 2005, the OCC, FDIC, and the Board of Governors of the Federal Reserve System adopted a final rule to revise their Community Reinvestment Act (CRA) regulations. The effective date of the final rule is September 1, 2005. Major points of the final rule include:

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increasing the asset-size threshold for a small bank to \$1 billion. Small banks are not subject to certain data collection and reporting requirements and are eligible for evaluation under the small bank lending test.

creating a new category of intermediate small banks for purposes of evaluation under the CRA. Intermediate small banks are those with at least \$250 million but less than \$1 billion in assets. The overall CRA rating for an intermediate small bank will be based both on the rating from the small bank lending test and the rating from a new community development test..

Revising the definition of community development to increase the number and kinds of rural tracts in which bank activities are eligible for community development consideration.

Revising the regulation to address the impact on a bank's CRA rating of evidence of discrimination or other illegal credit practices. In May 2005, the FRB adopted a final rule to amend Regulation DD and the related official staff interpretations, to improve the uniformity and adequacy of information to consumers about certain services provided by banks to their deposit customers. These services are commonly referred to as bounced-check protection or courtesy overdraft protection services (overdraft services). These amendments become effective on July 1, 2006. These amendments require banks to disclose information about overdraft fees on periodic statements and account-opening disclosures, and to include certain disclosures in advertisements for overdraft services. Regulation DD generally requires that banks disclose the amount of any fee that may be imposed in connection with the account and the conditions under which a fee may be imposed. The final rule amends the official staff interpretations to state that, in satisfying this requirement with respect to fees for overdraft services, a bank must specify the categories of transactions for which an overdraft fee may be imposed.

The Federal Reserve Board issued a final rule on March 1, 2005 that amends Regulation H and Regulation Y to limit restricted core capital elements (including trust preferred securities) which count as Tier 1 capital to 25 percent of all core capital elements, net of goodwill less any associated deferred tax liability. Internationally active bank holding companies, defined as those with consolidated assets greater than \$250 billion or on-balance-sheet foreign exposure greater than \$10 billion, will be subject to a 15 percent limit, but they may include qualifying mandatory convertible preferred securities up to the generally applicable 25 percent limit. Amounts of restricted core capital elements in excess of these limits generally may be included in Tier 2 capital. The final rule provides a five-year transition period, ending March 31, 2009, for application of the quantitative limits.

During July 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002. The purpose of the Sarbanes-Oxley Act is to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.

The Sarbanes-Oxley Act amends the Securities Exchange Act of 1934 to prohibit a registered public accounting firm from performing specified nonaudit services contemporaneously with a mandatory audit. The Sarbanes-Oxley Act also vests the audit committee of an issuer with responsibility for the appointment, compensation, and oversight of any registered public accounting firm employed to perform audit services. It requires each committee member to be a member of the board of directors of the issuer, and to be otherwise independent. The Sarbanes-Oxley Act further requires the chief executive officer and chief financial officer of an issuer to make certain certifications as to each annual or quarterly report filed with the SEC.

In addition, the Sarbanes-Oxley Act requires officers to forfeit certain bonuses and profits under certain circumstances. Specifically, if an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer as a result of misconduct with any financial reporting requirement under the securities laws, the chief executive officer and chief financial officer of the issuer shall be required to reimburse the issuer for (1) any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the first public issuance or filing with the SEC of the financial document embodying such financial reporting requirement; and (2) any profits realized from the sale of securities of the issuer during that 12-month period.

The Sarbanes-Oxley Act also instructs the SEC to require by rule:

disclosure of all material off-balance sheet transactions and relationships that may have a material effect upon the financial status of an issuer; and

the presentation of non GAAP pro forma financial information in a manner that is not misleading, and which is reconcilable with the financial condition of the issuer under generally accepted accounting principles.

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The Sarbanes-Oxley Act also prohibits insider transactions in the Company's stock during lock out periods of the Company's pension plans, and any profits on such insider transactions are to be disgorged. In addition, there is a prohibition of company loans to its executives, except in certain circumstances. The Sarbanes-Oxley Act also provides for mandated internal control report and assessment with the annual report and an attestation and a report on such report by the Company's auditor. The SEC is also required to issue a code of ethics for senior financial officers of the company. Further, the Sarbanes-Oxley Act adds a criminal penalty of fines and imprisonment of up to 10 years for securities fraud.

It is impossible to predict what effect the enactment of certain of the above-mentioned legislation will have on the Company. Moreover, it is likely that other bills affecting the business of banks may be introduced in the future by the United States Congress or California legislature.

Employees

At December 31, 2006, the Company employed 136 persons on a full-time equivalent basis. The Company believes its employee relations are excellent.

Available Information

The Company files period reports and other reports under the Securities and Exchange Act of 1934 with the Securities and Exchange Commission (SEC). These reports, as well as the Company's Code of Ethics, are posted and are available at no cost on the Company's website at <http://www.unitedsecuritybank.com> as soon as reasonably practical after the Company files such reports with the SEC. The Company's periodic and other reports filed with the SEC are also available at the SEC's website (<http://www.sec.gov>).

Item 1A. Risk Factors

There are risk factors that may affect the Company's business and impact the results of operations, some of which are beyond the control of the Company.

The Company's financial performance is subject to interest rate risk.

The Company's operations are greatly influenced by general economic conditions and by related monetary and fiscal policies of the federal government. Deposit flows and the funding costs are influenced by interest rates of competing investments and general market rates of interest. Lending activities are affected by the demand for loans, which in turn is affected by the interest rates at which such financing may be offered and by other factors affecting the availability of funds.

The Company's performance is substantially dependent on net interest income, which is the difference between the interest income received from interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities. To reduce the Company's exposure to interest rate fluctuations, management seeks to manage the balances of interest sensitive assets and liabilities, and maintain appropriate maturity and repricing parameters for these assets and liabilities. A mismatch between the amount of rate sensitive assets and rate sensitive liabilities in any time period may expose the Company to interest rate risk. Generally, if rate sensitive assets exceed rate sensitive liabilities, the net interest margin will be positively impacted during a rising rate environment and negatively impacted during a declining rate environment. When rate sensitive liabilities exceed rate sensitive assets, the net interest margin will generally be positively impacted during a declining rate environment and negatively impacted during a rising rate environment.

Increases in the level of interest rates may reduce the overall level of loans originated by the Company, and, thus, the amount of loan and commitment fees earned, as well as the market value of investment securities and other interest-earning assets. Moreover, fluctuations in interest rates may also result in disintermediation, which is the flow of funds away from depository institutions into direct investments, such as corporate securities and other investment vehicles which, because of the absence of federal deposit insurance, generally pay higher rates of return than depository institutions.

The deterioration of local economic conditions in the Company's market area could hurt profitability.

The Company's operations are located primarily in Fresno, Madera, and Kern Counties and are concentrated in Fresno County and surrounding areas. As a result of this geographic concentration, the Company's financial results depend largely upon economic conditions in these areas. The local economy in the Company's market areas rely heavily on agriculture, real estate, professional and business services, manufacturing, trade and tourism. A significant economic downturn such as that experienced after the September 11, 2001 tragedy in any or all of these industries could result in a decline in the local economy in general, which could in turn negatively impact the Company's operations and financial condition. Poor economic conditions could cause the Company to incur losses associated with higher default rates and decreased collateral values in the loan portfolio.

Concentrations in commercial and industrial loans, real estate-secured commercial loans, and real estate construction loans, may expose the Company to increased lending risks, especially in the event of a recession.

The Company has significant concentrations in commercial real estate and real estate construction loans. As of December 31, 2006, 14.3%, and 33.7% of the Company's loan portfolio was concentrated in these two categories, respectively. In addition, the Company has many commercial loans to businesses in the construction and real estate industry. There has been a relatively rapid increase in real estate values in the Company's market area in recent years, and the occurrence of a real estate recession affecting these market areas would likely reduce the security for many of the Company's loans and adversely affect the ability of many of borrowers to repay loan balances due the Company and require increased provisions to the allowance for loan losses. Therefore, the Company's financial condition and results of operations may be adversely affected by a decline in the value of the real estate securing the Company's loans.

The Company faces strong competition, which may adversely affect its operating results.

In recent years, competition for bank customers, the source of deposits and loans for the Company, has greatly intensified. This competition includes:

larger regional and national banks and other FDIC insured depository institutions in many of the communities the Company serves;

finance companies, investment banking and brokerage firms, and insurance companies that offer bank-like products;

credit unions, which can offer highly competitive rates on loans and deposits because they receive tax advantages not available to commercial banks; and

technology-based financial institutions including large national and super-regional banks offering on-line deposit, bill payment, and mortgage loan application services.

Some of the financial services organizations with which the Company competes are not subject to the same degree of regulation as is imposed on bank holding companies and federally insured financial institutions. As a result, these nonbank competitors have certain advantages over the Company in accessing funding and in providing various banking-related services.

By virtue of their larger capital position, regional and national banks have substantially larger lending limits than the Company, and can provide certain services to their customers which the Company is not able to offer directly, such as trust and international services. Many of these larger banks also operate with greater economies of scale which result in lower operating costs than the Company on a per-unit basis.

Other existing single or multi-branch community banks, or new community bank start-ups, have marketing strategies similar to United Security Bancshares. These other community banks can open new branches in the communities the Company serves and compete directly for customers who want the high level of service community banks offer. Other community banks also compete for the same management personnel and the same potential acquisition and merger candidates. Ultimately, competition can drive down the Company's interest margins and reduce profitability, as well as make it more difficult for the Company to achieve its growth objectives.

The Company's growth and expansion strategy may not prove to be successful and as a result, its market value and profitability may suffer.

The Company plans to grow operations within its market area and expand into new market areas when it makes strategic business sense, however the Company's capacity to manage any such growth will depend primarily on the ability to attract and retain qualified personnel, monitor operations, maintain earnings and control costs. The Company expects to continue to grow its assets and deposits, the products and services which it offers and accordingly the scale of its operations. The Company's ability to manage growth successfully will depend on the ability to maintain cost controls and asset quality while attracting additional loans and deposits on favorable terms. If the Company grows too quickly and is not able to control costs and maintain asset quality, this rapid growth could materially adversely affect the financial performance of the Company. The future successful growth of the Company will depend on the ability of its officers and other key employees to continue to implement and improve operational, credit, financial, management and other internal risk controls and processes, reporting systems and procedures, and to manage a growing number of customer relationships. The Company may not successfully implement improvements to management information and control systems, and control procedures and processes, in an efficient or timely manner and may discover deficiencies in existing systems and controls. In particular, the Company's controls and procedures must be able to accommodate an increase in expected loan volume and the infrastructure that comes with growth. Thus, the Company's growth strategy may divert management from existing businesses and may require the Company to incur additional expenditures to expand its administrative and operational infrastructure. If the Company is unable to manage future expansion in its operations, it may experience compliance and operational problems, need to slow the pace of growth, or need to incur additional expenditures beyond current projections to support such growth, any one of which could adversely affect the Company's business and profitability.

The loss of any of the Company's executive officers or key personnel could be damaging to the business.

The Company depends upon the skills and reputations of its executive officers and key employees for its future success. The loss of any of these key persons or the inability to attract and retain other key personnel could adversely affect the Company's business operations.

The Company could experience loan losses, which exceed the overall allowance for loan losses.

The risk of credit losses on loans and leases varies with, among other things, general economic conditions, the type of loan being made, the creditworthiness of the borrower, and, in the case of collateralized loans, the value and marketability of the collateral. The Company maintains an allowance for loan losses based upon, among other things, historical experience, an evaluation of economic conditions, and regular reviews of delinquencies and loan portfolio quality. Based upon such factors, management makes various assumptions and determinations about the ultimate collectibility of the loan portfolio and provides an allowance for losses based upon a percentage of the outstanding balances and for specific loans where their collectibility is considered to be questionable.

As of December 31, 2006, the Company's allowance for loan losses was approximately \$8.4 million representing 1.67% of gross outstanding loans. Although management believes that the allowance is adequate, there can be no absolute assurance that it will be sufficient to cover future loan losses. Although the Company uses the best information available to make determinations with respect to adequacy of the allowance for loan losses, future adjustments may be necessary if economic conditions change substantially from the assumptions used or if negative developments occur with respect to non-performing or performing loans. If management's assumptions or conclusions prove to be incorrect and the allowance for loan losses is not adequate to absorb future losses, or if Company's regulatory agencies require an increase in the allowance for loan losses, the Company's earnings, and potentially its capital, could be significantly and adversely impacted.

The Company may become subject to environmental liability risk associated with lending activities.

A significant portion of the Company's loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, the Company may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require the Company to incur substantial expenses and may materially reduce the affected property's value or limit the ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although the Company has policies and procedures to perform an environmental review before initiating any foreclosure action on nonresidential real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on the Company's financial condition and results of operations.

The regulatory environment under which the Company operates may have an adverse impact on the banking industry.

The Company is subject to extensive regulatory supervision and oversight from both federal and state authorities. Regulatory oversight of the Company is provided by the Federal Reserve Bank (FRB) and the California Department of Financial Institutions (DFI). Future legislation and government may adversely impact the Company and the commercial banking industry in general. Future regulatory changes may also alter the structure and competitive relationship among financial institutions.

The Company may be exposed to compliance risk resulting from violations or nonconformity with laws, rules, regulations, internal policies and procedures, or ethical standards set forth by regulatory authorities. The Company may also be subject to compliance risk in situations where laws or rules governing certain products or activities of the Company's customers may be uncertain or untested. Compliance risk exposes the Company to fines, civil money penalties, payment of damages, and the potential voiding of contracts. Compliance risk can result in diminished reputation, reduced franchise value, limited business opportunities, and reduced growth potential.

If the Company lost a significant portion of its low-cost core deposits, it would negatively impact profitability.

The Company's profitability depends in part on its success in attracting and retaining a stable base of low-cost deposits. As of December 31, 2006, noninterest-bearing checking accounts comprised 37.1% of the Company's deposit base, and interest-bearing checking and money market accounts comprised an additional 8.3% and 23.1%, respectively. The Company considers these deposits to be core deposits. If the Company lost a significant portion of these low-cost deposits, it would negatively impact its profitability and long-term growth objectives. While Management generally does not believe these deposits are sensitive to interest-rate fluctuations, the competition for these deposits in the Company's market area is strong and if the Company were to lose a significant portion of these low-cost deposits, it would negatively affect business operations.

The Company's Internal controls and procedures may fail or be circumvented.

Management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based, in part, on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the Company's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect the Company's business, results of operations and financial condition.

The Company's information systems may experience an interruption or breach in security.

The Company relies heavily on communications and information systems to conduct its business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in customer relationship management, general ledger, deposit, loan and other systems. While the Company has policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of its information systems, there can be no assurance that we can prevent any such failures, interruptions or security breaches or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of the Company's information systems could damage our reputation, result in a loss of customer business, subject the Company to additional regulatory scrutiny, or expose it to civil litigation and possible financial liability, any of which could have a material adverse effect on the Company's financial condition and results of operations.

The Company continually encounters technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. The Company's future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in the Company's operations. Many of the Company's competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to the company's customers and even if such products and services are implemented, the Company may incur substantial costs in doing so. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on the Company's business, financial condition and results of operations.

The Company relies on dividends from its subsidiaries for most of its revenue.

United Security Bancshares is a separate and distinct legal entity from its subsidiaries. The Company receives substantially all of its revenue from dividends from its subsidiary, United Security Bank. These dividends are the principal source of funds to pay dividends on common stock and interest on the Company's junior subordinated debt. Various federal and/or state laws and regulations limit the amount of dividends that United Security Bank and certain non-bank subsidiaries may pay to United Security Bancshares. Also, United Security Bancshares' right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. In the event United Security Bank is unable to pay dividends to United Security Bancshares, the Company may not be able to service debt, pay obligations or pay dividends on common stock. The inability to receive dividends from United Security Bank could have a material adverse effect on United Security Bancshares' business, financial condition and results of operations.

The holders of the Company's junior subordinated debentures have rights that are senior to those of the Company's shareholders.

On June 28, 2001, the Company issued \$15.5 million of floating rate junior subordinated debentures in connection with a \$15.0 million trust preferred securities issuance by its subsidiary, United Security Bancshares Capital Trust I. The junior subordinated debentures mature in July 2031.

The Company conditionally guarantees payments of the principal and interest on the trust preferred securities. The Company's junior subordinated debentures are senior to holders of common stock. As a result, the Company must make payments on the junior subordinated debentures (and the related trust preferred securities) before any dividends can be paid on our common stock and, in the event of bankruptcy, dissolution or liquidation, the holders of the debentures must be satisfied before any distributions can be made to the holders of common stock. The Company has the right to defer distributions on our junior subordinated debentures (and the related trust preferred securities) for up to five years, during which time no dividends may be paid to holders of common stock.

Severe weather, natural disasters, acts of war or terrorism and other external events could significantly impact the Company's business.

Severe weather, natural disasters, including but not limited to earthquakes and droughts, acts of war or terrorism and other adverse external events could have a significant impact on the Company's ability to conduct business. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause the Company to incur additional expenses. Severe weather or natural disasters, acts of war or terrorism or other adverse external events may occur in the future. Although management has established disaster recovery policies and procedures, there can be no assurance of the effectiveness of such policies and procedures, and the occurrence of any such event could have a material adverse effect on the Company's business, financial condition and results of operations.

Item 1B. - Unresolved Staff Comments

The Company had no unresolved staff comments at December 31, 2006.

Item 2 - Properties

The Bank's Main bank branch is located at 2151 West Shaw Avenue, Fresno, California. The Company owns the building and leases the land under a sublease dated December 1, 1986 between Central Bank and USB. The current sublessor under the master ground lease is Bank of the West, which acquired the position through the purchase of Central Bank. The lessor under the ground lease (Master Lease) is Thomas F. Hinds. The lease expires on December 31, 2015 and the Company has options to extend the term for four (4) ten-year periods and one seven (7) year period.

The Company leases the banking premises of approximately 6,450 square feet for its second of three Fresno branches at 7088 N. First Ave, Fresno, California., under a lease which commenced August 2005 for a term of ten years expiring in July 2015. The branch was previously located at 1041 E. Shaw Avenue, Fresno, California, under a lease extension expiring February 28, 2005. The lease was renewed until August 2005. The new location currently provides space for the relocated branch as well as the Real Estate Construction Department and the Indirect Consumer Lending Department.

The Company leases the Oakhurst bank branch located at the Old Mill Village Shopping Center, 40074 Highway 49, and Oakhurst, California, which was completed during April of 1999. The Company had originally maintained two branches in the Oakhurst area, and at this time consolidated its two Oakhurst branches into the new facility. The current facility, which consists of approximately 5,000 square feet, will be leased for a term of 15 years ending April 2014, and there are two five-year options to extend the lease term after that date.

The Company owns the Caruthers bank branch located at 13356 South Henderson, Caruthers, California, which consists of approximately 5,000 square feet of floor space. The branch was purchased during May 2005 for \$425,000, at which time the operating lease under which the Company had been occupying the premises was canceled. The branch was originally acquired from Wells Fargo Bank in February 1997 under a lease, which expired January 19, 2006 with extensions to January 19, 2021.

The Company owns the San Joaquin branch facilities located at 21574 Manning Avenue, San Joaquin, California. The new bank branch is approximately 2,500 square feet.

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The Company owns the Firebaugh bank branch located at 1067 O Street, Firebaugh, California, which was purchased from Bank of America during October 1997. The premises are comprised of approximately 4,666 square feet of office space situated on land totaling approximately one-third of an acre.

The Company owns the Coalinga bank branch located at 145 East Durian, Coalinga, California, which was also purchased from Bank of America during October 1997. The office building has a total of 6,184 square feet of interior floor space situated on approximately 0.45 acres of land.

The Company leases the Convention Center branch located at 855 M Street, Suite 130, Fresno, California. Total space leased is approximately 4,520 square feet, and was occupied during March 2004. The fifteen-year lease expires in March 2019. There are no extension provisions.

The Company owns the Taft branch office premises located at 523 Cascade Place, Taft, California. The branch facilities consist of approximately 9,200 square feet of office space. The Taft premises were previously leased and were purchased during July 2005 at a cost of \$1.0 million. The Taft branch facilities were acquired during April 2004 as the result of the merger with Taft National Bank, under a lease agreement expiring in November 2007.

The Company owns the branch facilities located at 3404 Coffee Road, Bakersfield, California, which