UNITED SECURITY BANCSHARES
Form 10-Q
November 05, 2015

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2015
o	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: 000-32897

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

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

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

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

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

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 x No o

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

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

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

Common Stock, no par value

(Title of Class)

Shares outstanding as of October 31, 2015: 15,892,488

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PART I. Financial Information

United Security Bancshares and Subsidiaries
Consolidated Balance Sheets – (unaudited)
September 30, 2015 and December 31, 2014

(in thousands except shares)	September 30, 2015	December 31, 2014
Assets		
Cash and non-interest bearing deposits in other banks	$23,458	$21,348
Cash and due from Federal Reserve Bank	92,930	82,229
Cash and cash equivalents	116,388	103,577
Interest-bearing deposits in other banks	1,526	1,522
Investment securities available for sale (at fair value)	34,423	48,301
Loans	515,701	457,919
Unearned fees and unamortized loan origination costs, net	145	(324)
Allowance for credit losses	(11,573)	(10,771)
Net loans	504,273	446,824
Accrued interest receivable	2,172	1,927
Premises and equipment – net	10,944	11,550
Other real estate owned	12,689	14,010
Goodwill	4,488	4,488
Cash surrender value of life insurance	18,106	17,717
Investment in limited partnerships	929	871
Deferred income taxes - net	6,712	6,853
Other assets	5,749	5,529
Total assets	$718,399	$663,169
Liabilities & Shareholders' Equity		
Liabilities		
Deposits		
Noninterest bearing	$258,678	$215,439
Interest bearing	357,957	349,934
Total deposits	616,635	565,373
Accrued interest payable	30	40
Accounts payable and other liabilities	5,834	4,815
Junior subordinated debentures (at fair value)	7,880	10,115
Total liabilities	630,379	580,343
Shareholders' Equity		
Common stock, no par value 20,000,000 shares authorized, 15,892,488 issued and outstanding at September 30, 2015, and 15,425,086 at December 31, 2014	51,726	49,271
Retained earnings	36,472	33,730
Accumulated other comprehensive loss	(178)	(175)
Total shareholders' equity	88,020	82,826
Total liabilities and shareholders' equity	$718,399	$663,169

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

(In thousands except shares and EPS)	Quarter Ended September 30, 2015	2014	Nine Months Ended September 30, 2015	2014
Interest Income:				
Loans, including fees	$6,728	$6,187	$19,641	$17,602
Investment securities – AFS – taxable	175	227	555	688
Interest on deposits in FRB	55	63	138	210
Interest on deposits in other banks	1	2	5	5
Total interest income	6,959	6,479	20,339	18,505
Interest Expense:				
Interest on deposits	268	291	780	812
Interest on other borrowings	58	59	175	183
Total interest expense	326	350	955	995
Net Interest Income	6,633	6,129	19,384	17,510
(Recovery of Provision) Provision for Credit Losses	(23)	39	434	(101)
Net Interest Income after (Recovery of Provision) Provision for Credit Losses	6,656	6,090	18,950	17,611
Noninterest Income:				
Customer service fees	963	957	2,661	2,639
Increase in cash surrender value of bank-owned life insurance	130	129	389	384
Gain (loss) on fair value of financial liability	148	95	346	(34)
Gain on redemption of JR subordinated debentures	78	—	78	—
(Loss) gain on sale of investment in limited partnership	(23)	—	(23)	691
Gain on sale of premises and equipment	—	—	—	25
Other	153	130	463	428
Total noninterest income	1,449	1,311	3,914	4,133
Noninterest Expense:				
Salaries and employee benefits	2,341	2,303	7,044	7,108
Occupancy expense	1,047	966	3,021	2,795
Data processing	29	32	90	101
Professional fees	277	452	877	959
Regulatory assessments	234	228	705	700
Director fees	78	59	202	176
Amortization of intangibles	—	—	—	62
Correspondent bank service charges	19	30	56	89
(Gain) Loss on California tax credit partnership	(1)	(62)	60	(15)
Net cost on operation of OREO	401	116	594	480
Other	589	493	1,755	1,700
Total noninterest expense	5,014	4,617	14,404	14,155
Income Before Provision for Taxes	3,091	2,784	8,460	7,589
Provision for Taxes on Income	1,205	1,081	3,283	2,930
Net Income	$1,886	$1,703	$5,177	$4,659
Net Income per common share				
Basic	$0.12	$0.11	$0.33	$0.29

Diluted	$0.12	$0.11	$0.33	$0.29
Shares on which net income per common shares were based				
Basic	15,892,488	15,881,387	15,892,488	15,867,346
Diluted	15,894,532	15,886,397	15,894,444	15,874,192

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

(In thousands)	Three Months Ended September 30, 2015	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2015	Nine Months Ended September 30, 2014
Net Income	$1,886	$1,703	$5,177	$4,659
Unrealized holdings gains (losses) on securities	189	(95)	(58)	(87)
Unrealized gains on unrecognized post-retirement costs	19	16	55	47
Other comprehensive income (loss), before tax	208	(79)	(3)	(40)
Tax (expense) benefit related to securities	(76)	38	23	35
Tax expense related to unrecognized post-retirement costs	(8)	(6)	(23)	(20)
Total other comprehensive income (loss)	124	(47)	(3)	(25)
Comprehensive income	$2,010	$1,656	$5,174	$4,634

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

(In thousands except shares)	Common stock Number of Shares	Amount	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance December 31, 2013	14,799,888	$45,778	$30,884	$ (119)	$76,543
Other comprehensive loss				(25)	(25)
Common stock dividends	448,572	2,524	(2,524)		—
Stock options exercised	23,922	95			95
Stock-based compensation expense		23			23
Net income			4,659		4,659
Balance September 30, 2014	15,272,382	$48,420	$33,019	$ (144)	$81,295
Other comprehensive loss				(31)	(31)
Common stock dividends	152,704	846	(846)		—
Stock-based compensation expense		5			5
Net income			1,557		1,557
Balance December 31, 2014	15,425,086	$49,271	$33,730	$ (175)	$82,826
Other comprehensive loss				(3)	(3)
Common stock dividends	467,402	2,435	(2,435)		—
Stock-based compensation expense		20			20
Net income			5,177		5,177
Balance September 30, 2015	15,892,488	$51,726	$36,472	$ (178)	$88,020

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

	Nine months ended September 30,	
(In thousands)	2015	2014
Cash Flows From Operating Activities:		
Net Income	$5,177	$4,659
Adjustments to reconcile net income:to cash provided by operating activities:		
Provision (recovery of provision) for credit losses	434	(101)
Depreciation and amortization	1,101	1,011
Amortization of investment securities	205	190
Accretion of investment securities	(24)	(26)
Increase in accrued interest receivable	(245)	(280)
Decrease in accrued interest payable	(10)	(2)
Decrease in accounts payable and accrued liabilities	(165)	(1,113)
(Decrease) increase in unearned fees	(469)	121
Increase in income taxes payable	1,181	2,936
Stock-based compensation expense	20	23
Benefit for deferred income taxes	142	(14)
Gain on sale of other real estate owned	(17)	(109)
Write down on other real estate owned	188	—
Increase in cash surrender value of bank-owned life insurance	(389)	(384)
(Gain) Loss on fair value option of financial liabilities	(346)	34
(Gain) on redemption of Jr subordinated debentures	(78)	—
Loss (gain) on tax credit limited partnership interest	60	(15)
Amortization of intangibles	—	62
Loss (gain) on sale of investment in limited partnership	23	(691)
Gain on sale of premises and equipment	—	(25)
Net decrease in other assets	(49)	(170)
Net cash provided by operating activities	6,739	6,106
Cash Flows From Investing Activities:		
Net increase in interest-bearing deposits with banks	(4)	(5)
Purchase of correspondent bank stock	(147)	(97)
Purchases of available-for-sale securities	—	(10,192)
Maturities of available-for-sale securities	9,000	—
Principal payments of available-for-sale securities	4,639	3,934
Net increase in loans	(57,456)	(50,199)
Cash proceeds from sales of other real estate owned	1,192	1,020
Investment in limited partnership	(119)	(70)
Cash proceeds from sale of investment in limited partnership	—	1,250
Capital expenditures of premises and equipment	(495)	(628)
Net cash used in investing activities	(43,390)	(54,987)
Cash Flows From Financing Activities:		
Net increase in demand deposits and savings accounts	58,232	55,365
Net (decrease) in certificates of deposit	(6,970)	(6,906)
Redemption of Jr subordinated debentures	(1,800)	—

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Proceeds from exercise of stock options	—	95
Net cash provided by financing activities	49,462	48,554
Net increase (decrease) in cash and cash equivalents	12,811	(327)
Cash and cash equivalents at beginning of period	103,577	135,212
Cash and cash equivalents at end of period	$116,388	$134,885

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

1. Organization and Summary of Significant Accounting and Reporting Policies

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

These unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information on a basis consistent with the accounting policies reflected in the audited financial statements of the Company included in its 2014 Annual Report on Form 10-K. These interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of a normal, recurring nature) considered necessary for a fair presentation have been included. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for any other interim period or for the year as a whole.

Recently Issued Accounting Standards:

In January 2014, FASB issued ASU 2014-04, Receivables - Troubled Debt Restructurings by Creditors. The amendments in this ASU clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this ASU using either a modified retrospective transition method or a prospective transition method. Early adoption is permitted. The adoption of this update did not have a significant impact on the Company's consolidated financial statements.

In January 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-01 Accounting for Investments in Qualified Affordable Housing Projects. This ASU provides "guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit." It allows the proportional amortization method to be used by a reporting entity if certain conditions are met. The ASU also defines when a qualified affordable housing project through a limited liability entity should be tested for impairment. If a qualified affordable housing project does not meet the conditions for using the proportional amortization method, the investment should be accounted for using an equity method investment or a cost method investment. The ASU is effective for fiscal years beginning after December 15, 2014, and interim periods therein. The Company will continue to account for our low-income housing tax credit investments using the equity method subsequent to the adoption of ASU 2014-01 and does not expect any impact on the Company's consolidated financial statements.

2. Investment Securities

Following is a comparison of the amortized cost and fair value of securities available-for-sale, as of September 30, 2015 and December 31, 2014:

(in 000's) September 30, 2015 Securities available for sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
U.S. Government agencies	$10,232	$482	$(112)	$10,602
U.S. Government collateralized mortgage obligations	19,704	270	—	19,974
Mutual Funds	4,000	—	(153)	3,847
Total securities available for sale	$33,936	$752	$(265)	$34,423

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(in 000's) December 31, 2014 Securities available for sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
U.S. Government agencies	$12,097	$399	$—	$12,496
U.S. Government collateralized mortgage obligations	31,659	336	(13)	31,982
Mutual Funds	4,000	—	(177)	3,823
Total securities available for sale	$47,756	$735	$(190)	$48,301

The amortized cost and fair value of securities available for sale at September 30, 2015, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties. Contractual maturities on collateralized mortgage obligations cannot be anticipated due to allowed paydowns. Mutual funds are included in the "due in one year or less" category below.

	September 30, 2015	
(in 000's)	Amortized Cost	Fair Value (Carrying Amount)
Due in one year or less	$4,000	$3,847
Due after one year through five years	17	17
Due after five years through ten years	—	—
Due after ten years	10,215	10,585
Collateralized mortgage obligations	19,704	19,974
	$33,936	$34,423

There were no realized gains or losses on sales of available-for-sale securities for the three and nine month periods ended September 30, 2015 and September 30, 2014. There were no other-than-temporary impairment losses for the three and nine month periods ended September 30, 2015 and September 30, 2014.

At September 30, 2015, available-for-sale securities with an amortized cost of approximately $17,244,209 (fair value of $17,774,050) were pledged as collateral for FHLB borrowings and public funds balances.

The Company had no held-to-maturity or trading securities at September 30, 2015 or December 31, 2014.

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

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The following summarizes temporarily impaired investment securities:

(in 000's)	Less than 12 Months		12 Months or More		Total	
September 30, 2015 Securities available for sale:	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses
U.S. Government agencies	$—	$—	$82	$(112)	$82	$(112)
U.S. Government agency collateral mortgage obligations	—	—	—	—	—	—
Mutual Funds	3,847	(153)	—	—	3,847	(153)
Total impaired securities	$3,847	$(153)	$82	$(112)	$3,929	$(265)
December 31, 2014 Securities available for sale:						
U.S. Government agencies	$—	$—	$—	$—	$—	$—
U.S. Government agency collateral mortgage obligations	6,478	(13)	—	—	6,478	(13)
Mutual Funds	—	—	3,823	(177)	3,823	(177)
Total impaired securities	$6,478	$(13)	$3,823	$(177)	$10,301	$(190)

Temporarily impaired securities at September 30, 2015, were comprised of one mutual fund and one U.S. government agency security.

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

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

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

Additionally, other-than-temporary-impairment occurs when the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If the Company intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary-impairment shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the other-than-temporary-impairment shall be separated into

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the amount representing the credit loss and the amount related to all other factors. The amount of the total other-than-temporary-impairment related to the credit loss is recognized in earnings, and is determined based on the difference between the present value of cash flows expected to be collected and the current amortized cost of the security. The amount of the total other-than-temporary-impairment related to other factors shall be recognized in other comprehensive (loss) income, net of applicable taxes. The previous amortized cost basis less the other-than-temporary-impairment recognized in earnings shall become the new amortized cost basis of the investment.

At September 30, 2015, the decline in market value of the impaired mutual fund and U.S. government agency security is attributable to changes in interest rates, and not credit quality. Because the Company does not have the intent to sell these impaired securities, and it is not more likely than not that it will be required to sell these securities before its anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired at September 30, 2015.

3. Loans

Loans are comprised of the following:

(in 000's)	September 30, 2015	December 31, 2014
Commercial and Business Loans	$62,648	$60,422
Government Program Loans	1,616	1,947
Total Commercial and Industrial	64,264	62,369
Real Estate – Mortgage:		
Commercial Real Estate	165,065	154,672
Residential Mortgages	72,452	59,095
Home Improvement and Home Equity loans	960	1,110
Total Real Estate Mortgage	238,477	214,877
Real Estate Construction and Development	150,888	137,158
Agricultural	43,025	31,713
Installment	19,047	11,802
Total Loans	$515,701	$457,919

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

Commercial and industrial loans represent 12.5% of total loans at September 30, 2015 and are generally made to support the ongoing operations of small-to-medium sized commercial businesses. Commercial and industrial loans have a high degree of industry diversification and provide working capital, financing for the purchase of manufacturing plants and equipment, or funding for growth and general expansion of businesses. A substantial portion of commercial and industrial loans are secured by accounts receivable, inventory, leases, or other collateral including real estate. The remainder are unsecured; however, extensions of credit are predicated upon the financial capacity of the borrower. Repayment of commercial loans is generally from the cash flow of the borrower.

Real estate mortgage loans, representing 46.2% of total loans at September 30, 2015, are secured by trust deeds on primarily commercial property, but are also secured by trust deeds on single family residences. Repayment of real estate mortgage loans generally comes from the cash flow of the borrower.

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

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- Residential mortgage loans are provided to individuals to finance or refinance single-family residences. Residential mortgages are not a primary business line offered by the Company, and a majority are conventional mortgages that were purchased as a pool. Most residential mortgages originated by the Company are of a shorter term than conventional mortgages, with maturities ranging from 3 to 15 years on average.

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

Real estate construction and development loans, representing 29.3% of total loans at September 30, 2015, consist of loans for residential and commercial construction projects, as well as land acquisition and development, or land held for future development. Loans in this category are secured by real estate including improved and unimproved land, as well as single-family residential, multi-family residential, and commercial properties in various stages of completion. All real estate loans have established equity requirements. Repayment on construction loans generally comes from long-term mortgages with other lending institutions obtained at completion of the project.

Agricultural loans represent 8.3% of total loans at September 30, 2015 and are generally secured by land, equipment, inventory and receivables. Repayment is from the cash flow of the borrower.

Installment loans represent 3.7% of total loans at September 30, 2015 and generally consist of loans to individuals for household, family and other personal expenditures such as credit cards, automobiles or other consumer items.

In the normal course of business, the Company is party to financial instruments with off-balance sheet risk to meet the financing needs of its customers. At September 30, 2015 and December 31, 2014, these financial instruments include commitments to extend credit of $112,665,000 and $105,434,000, respectively, and standby letters of credit of $3,009,000 and $3,800,000, respectively. These instruments involve elements of credit risk in excess of the amount recognized on the consolidated balance sheet. The contract amounts of these instruments reflect the extent of the involvement the Company has in off-balance sheet financial instruments.

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

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

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

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Past Due Loans

The Company monitors delinquency and potential problem loans on an ongoing basis through weekly reports to the Loan Committee and monthly reports to the Board of Directors. The following is a summary of delinquent loans at September 30, 2015 (in 000's):

September 30, 2015	Loans 30-60 Days Past Due	Loans 61-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and Business Loans	$—	$—	$962	$962	$61,686	$62,648	$—
Government Program Loans	—	—	19	19	1,597	1,616	19
Total Commercial and Industrial	—	—	981	981	63,283	64,264	19
Commercial Real Estate Loans	—	747	—	747	164,318	165,065	—
Residential Mortgages	—	63	267	330	72,122	72,452	—
Home Improvement and Home Equity Loans	—	—	—	—	960	960	—
Total Real Estate Mortgage	—	810	267	1,077	237,400	238,477	—
Real Estate Construction and Development Loans	—	—	—	—	150,888	150,888	—
Agricultural Loans	—	—	—	—	43,025	43,025	—
Consumer Loans	—	—	450	450	18,382	18,832	—
Overdraft Protection Lines	—	—	—	—	78	78	—
Overdrafts	—	—	—	—	137	137	—
Total Installment	—	—	450	450	18,597	19,047	—
Total Loans	$—	$810	$1,698	$2,508	$513,193	$515,701	$19

The following is a summary of delinquent loans at December 31, 2014 (in 000's):

December 31, 2014	Loans 30-60 Days Past Due	Loans 61-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and Business Loans	$962	$—	$—	$962	$59,460	$60,422	$—
Government Program Loans	445	—	—	445	1,502	1,947	—
Total Commercial and Industrial	1,407	—	—	1,407	60,962	62,369	—
Commercial Real Estate Loans	463	—	—	463	154,209	154,672	—
Residential Mortgages	—	90	162	252	58,843	59,095	—
Home Improvement and Home Equity Loans	43	—	42	85	1,025	1,110	—
	506	90	204	800	214,077	214,877	—

Total Real Estate Mortgage							
Real Estate Construction and Development Loans	—	—	—	—	137,158	137,158	—
Agricultural Loans	—	—	—	—	31,713	31,713	—
Consumer Loans	67	—	—	67	11,428	11,495	—
Overdraft Protection Lines	—	—	—	—	92	92	—
Overdrafts	—	—	—	—	215	215	—
Total Installment	67	—	—	67	11,735	11,802	—
Total Loans	$1,980	$90	$204	$2,274	$455,645	$457,919	$—

Nonaccrual Loans

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

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

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

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

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

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

All other loans where principal or interest is due and unpaid for 90 days or more are placed on nonaccrual and the accrual of interest for financial statement purposes is discontinued. Previously accrued but unpaid interest is reversed and charged against interest income.

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

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

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

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

Nonaccrual loans totaled $8,248,000 and $9,935,000 at September 30, 2015 and December 31, 2014, respectively. There were no remaining undisbursed commitments to extend credit on nonaccrual loans at September 30, 2015 or December 31, 2014.

The following is a summary of nonaccrual loan balances at September 30, 2015 and December 31, 2014 (in 000's).

	September 30, 2015	December 31, 2014
Commercial and Business Loans	$962	$12
Government Program Loans	348	421
Total Commercial and Industrial	1,310	433
Commercial Real Estate Loans	1,280	3,145
Residential Mortgages	267	1,174
Home Improvement and Home Equity Loans	—	42
Total Real Estate Mortgage	1,547	4,361

Real Estate Construction and Development Loans	4,941	5,141
Agricultural Loans	—	—
Consumer Loans	450	—
Overdraft Protection Lines	—	—
Overdrafts	—	—
Total Installment	450	—
Total Loans	$8,248	$9,935

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Impaired Loans

A loan is considered impaired when based on current information and events, it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the loan agreement.

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

A loan is not considered impaired if there is merely an insignificant delay or shortfall in the amounts of payments and the Company expects to collect all amounts due, including interest accrued, at the contractual interest rate for the period of the delay.

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

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

- For loans secured by collateral including real estate and equipment, the fair value of the collateral less selling costs will determine the carrying value of the loan. The difference between the recorded investment in the loan and the fair value, less selling costs, determines the amount of impairment. The Company uses the measurement method based on fair value of collateral when the loan is collateral dependent and foreclosure is probable. For loans that are not considered collateral dependent, a discounted cash flow methodology is used.

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

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

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

Loans other than certain homogeneous loan portfolios are reviewed on a quarterly basis for impairment. Impaired loans are written down to estimated realizable values by the establishment of specific reserves for loan utilizing the discounted cash flow method, or charge-offs for collateral-based impaired loans, or those using observable market pricing.

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The following is a summary of impaired loans at September 30, 2015 (in 000's).

September 30, 2015	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance (1)	Recorded Investment With Allowance (1)	Total Recorded Investment	Related Allowance	Average Recorded Investment (2)	Interest Recognized (2)
Commercial and Business Loans	$1,723	$530	$1,195	$1,725	$1,019	$1,568	$28
Government Program Loans	348	348	—	348	—	381	22
Total Commercial and Industrial	2,071	878	1,195	2,073	1,019	1,949	50
Commercial Real Estate Loans	1,279	—	1,279	1,279	512	2,093	51
Residential Mortgages	3,827	1,222	2,613	3,835	160	4,161	153
Home Improvement and Home Equity Loans	—	—	—	—	—	21	—
Total Real Estate Mortgage	5,106	1,222	3,892	5,114	672	6,275	204
Real Estate Construction and Development Loans	6,114	5,411	708	6,119	143	6,244	303
Agricultural Loans	20	20	—	20	—	27	7
Consumer Loans	1,100	—	1,105	1,105	585	1,055	26
Overdraft Protection Lines	—	—	—	—	—	—	—
Overdrafts	—	—	—	—	—	—	—
Total Installment	1,100	—	1,105	1,105	585	1,055	26
Total Impaired Loans	$14,411	$7,531	$6,900	$14,431	$2,419	$15,550	$590

(1) The recorded investment in loans includes accrued interest receivable of $20,000.
(2) Information is based on the nine month period ended September 30, 2015.

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The following is a summary of impaired loans at December 31, 2014 (in 000's).

December 31, 2014	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance (1)	Recorded Investment With Allowance (1)	Total Recorded Investment	Related Allowance	Average Recorded Investment (2)	Interest Recognized (2)
Commercial and Business Loans	$996	$770	$230	$1,000	$64	$847	$76
Government Program Loans	421	421	—	421	—	250	28
Total Commercial and Industrial	1,417	1,191	230	1,421	64	1,097	104
Commercial Real Estate Loans	3,145	1,794	1,351	3,145	478	5,765	244
Residential Mortgages	4,315	1,474	2,852	4,326	170	4,564	188
Home Improvement and Home Equity Loans	42	42	—	42	—	11	3
Total Real Estate Mortgage	7,502	3,310	4,203	7,513	648	10,340	435
Real Estate Construction and Development Loans	6,367	6,371	—	6,371	—	3,362	209
Agricultural Loans	32	32	—	32	—	37	9
Consumer Loans	695	655	45	700	3	209	37
Overdraft Protection Lines	—	—	—	—	—	—	—
Overdrafts	—	—	—	—	—	—	—
Total Installment	695	655	45	700	3	209	37
Total Impaired Loans	$16,013	$11,559	$4,478	$16,037	$715	$15,045	$794

(1) The recorded investment in loans includes accrued interest receivable of $24,000.
(2) Information is based on the twelve month period ended December 31, 2014.

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

The average recorded investment in impaired loans for the quarters ended September 30, 2015 and 2014 was $14,506,000 and $14,436,000, respectively. Interest income recognized on impaired loans for the quarters ended September 30, 2015 and 2014 was approximately $199,000 and $176,000, respectively. For impaired nonaccrual loans, interest income recognized under a cash-basis method of accounting was approximately $126,000 and $117,000 for the quarters ended September 30, 2015 and 2014, respectively.

The average recorded investment in impaired loans for the nine months ended September 30, 2015 and 2014 was $15,550,000 and $14,714,000, respectively. Interest income recognized on impaired loans for the nine months ended September 30, 2015 and 2014 was approximately $590,000 and $463,000, respectively. For impaired nonaccrual loans, interest income recognized under a cash-basis method of accounting was approximately $326,000 and $264,000 for the nine months ended September 30, 2015 and 2014, respectively.

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Troubled Debt Restructurings

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

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

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

- A transfer from the borrower to the Company of receivables from third parties, real estate, other assets, or an equity interest in the borrower is granted to fully or partially satisfy the loan.

- A modification of terms of a debt such as one or a combination of:

The reduction (absolute or contingent) of the stated interest rate.
The extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk.
The reduction (absolute or contingent) of the face amount or maturity amount of debt as stated in the instrument or agreement.
The reduction (absolute or contingent) of accrued interest.

For a restructured loan to return to accrual status there needs to be, among other factors, at least 6 months successful payment history. In addition, the Company performs a financial analysis of the credit to determine whether the borrower has the ability to continue to meet payments over the remaining life of the loan. This includes, but is not limited to, a review of financial statements and cash flow analysis of the borrower. Only after determination that the borrower has the ability to perform under the terms of the loans, will the restructured credit be considered for accrual status. Although the Company does not have a policy which specifically addresses when a loan may be removed from TDR classification, as a matter of practice, loans classified as TDRs generally remain classified as such until the loan either reaches maturity or its outstanding balance is paid off.

The following tables illustrates TDR activity for the periods indicated:

	Three Months Ended September 30, 2015				
($ in 000's)	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts which Defaulted During Period	Recorded Investment on Defaulted TDRs
Troubled Debt Restructurings					
Commercial and Business Loans	1	$81	$81	—	$—
Government Program Loans	—	—	—	—	—
Commercial Real Estate Term Loans	—	—	—	—	—
Single Family Residential Loans	—	—	—	—	—
Home Improvement and Home Equity Loans	—	—	—	—	—
	—	—	—	—	—

Real Estate Construction and Development Loans					
Agricultural Loans	—	—	—	—	—
Consumer Loans	—	—	—	—	—
Overdraft Protection Lines	—	—	—	—	—
Total Loans	1	$81	$81	—	$—

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	Nine Months Ended September 30, 2015				
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts which Defaulted During Period	Recorded Investment on Defaulted TDRs
Troubled Debt Restructurings					
Commercial and Business Loans	2	$339	$335	—	$—
Government Program Loans	—	—	—	—	—
Commercial Real Estate Term Loans	—	—	—	—	—
Single Family Residential Loans	—	—	—	—	—
Home Improvement and Home Equity Loans	—	—	—	—	—
Real Estate Construction and Development Loans	—	—	—	—	—
Agricultural Loans	—	—	—	—	—
Consumer Loans	—	—	—	—	—
Overdraft Protection Lines	—	—	—	—	—
Total Loans	2	$339	$335	—	$—

	Three Months Ended September 30, 2014				
($ in 000's)	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts which Defaulted During Period	Recorded Investment on Defaulted TDRs
Troubled Debt Restructurings					
Commercial and Business Loans	2	$300	$286	—	$—
Government Program Loans	—	—	—	—	—
Commercial Real Estate Term Loans	—	—	—	—	—
Single Family Residential Loans	—	—	—	1	162
Home Improvement and Home Equity Loans	—	—	—	—	—
Real Estate Construction and Development Loans	—	—	—	—	—
Agricultural Loans	—	—	—	—	—
Consumer Loans	—	—	—	—	—
Overdraft Protection Lines	—	—	—	—	—
Total Loans	2	$300	$286	1	$162

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($ in 000's)	Nine Months Ended September 30, 2014 Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts which Defaulted During Period	Recorded Investment on Defaulted TDRs
Troubled Debt Restructurings					
Commercial and Business Loans	3	$350	$335	1	$—
Government Program Loans	1	544	534	1	—
Commercial Real Estate Term Loans	—	—	—	—	—
Single Family Residential Loans	—	—	—	3	657
Home Improvement and Home Equity Loans	—	—	—	—	—
Real Estate Construction and Development Loans	—	—	—	2	394
Agricultural Loans	—	—	—	—	—
Consumer Loans	—	—	—	—	—
Overdraft Protection Lines	—	—	—	—	—
Total Loans	4	$894	$869	7	$1,051

The Company makes various types of concessions when structuring TDRs including rate reductions, payment extensions, and forbearance. At September 30, 2015, the Company had 29 restructured loans totaling $12,312,000 as compared to 33 restructured loans totaling $15,000,000 at December 31, 2014.

The following tables summarize TDR activity by loan category for the nine months ended September 30, 2015 and September 30, 2014 (in 000's).

Nine Months Ended September 30, 2015	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Improvement and Home Equity	Real Estate Construction Development	Agricultural	Installment & Other	Total
Beginning balance	$1,306	$2,713	$4,225	$—	$6,029	$32	$695	$15,000
Defaults	—	—	—	—	—	—	—	—
Additions	81	—	256	—	—	—	—	337
Principal reductions	(376)	(1,434)	(922)	—	(236)	(12)	(45)	(3,025)
Ending balance	$1,011	$1,279	$3,559	$—	$5,793	$20	$650	$12,312
Allowance for loan loss	$36	$512	$160	$—	$79	$—	$135	$922

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Nine Months Ended September 30, 2014	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Improvement and Home Equity	Real Estate Construction Development	Agricultural	Installment & Other	Total
Beginning balance	$675	$1,468	$5,273	$ —	$ 1,551	$44	$48	$9,059
Defaults	—	—	(656)	—	(395)	—	—	(1,051)
Additions	894	—	—	—	—	—	—	894
Principal reductions	(694)	(88)	(360)	—	(670)	(9)	(3)	(1,824)
Ending balance	$875	$1,380	$4,257	$ —	$ 486	$35	$45	$7,078
Allowance for loan loss	$47	$486	$184	$ —	$ —	$—	$2	$719

The following tables summarize TDR activity by loan category for the quarters ended September 30, 2015 and September 30, 2014.

Three months ended September 30, 2015	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Improvement and Home Equity	Real Estate Construction Development	Agricultural	Installment & Other	Total
Beginning balance	$975	$1,302	$3,638	$ —	$ 5,870	$24	$650	$12,459
Defaults	—	—	—	—	—	—	—	—
Additions	81	—	—	—	—	—	—	81
Principal reductions	(45)	(23)	(79)	—	(77)	(4)	—	(228)
Ending balance	$1,011	$1,279	$3,559	$ —	$ 5,793	$20	$650	$12,312
Allowance for loan loss	$36	$512	$160	$ 0	$ 79	$—	$135	$922

Three months ended September 30, 2014	Commercial and Industrial	Commercial Real Estate	Residential Mortgages	Home Improvement and Home Equity	Real Estate Construction Development	Agricultural	Installment & Other	Total
Beginning balance	$1,107	$1,410	$4,536	$ —	$ 490	$38	$46	$7,627
Defaults	—	—	(162)	—	—	—	—	(162)
Additions	300	—	—					