Oak Valley Bancorp
Form 10-Q
November 14, 2013
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UNITED STATES

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, 2013

OR

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 001-34142

OAK VALLEY BANCORP

(Exact name of registrant as specified in its charter)

California	**26-2326676**

State or other jurisdiction of incorporation or organization	I.R.S. Employer Identification No.

125 N. Third Ave., Oakdale, CA 95361

(Address of principal executive offices)

(209) 848-2265

Issuer s telephone number

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 7,929,730 shares of common stock outstanding as of October 31, 2013.

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Oak Valley Bancorp

September 30, 2013

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PART I FINANCIAL STATEMENTS

Item 1. Consolidated Financial Statements (Unaudited)

OAK VALLEY BANCORP

CONDENSED CONSOLIDATED BALANCE SHEETS

AT SEPTEMBER 30, 2013 (UNAUDITED) AND DECEMBER 31, 2012 (AUDITED)

	September 30, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$ 84,312,827	$ 130,799,998
Federal funds sold	15,495,000	10,535,000
Cash and cash equivalents	99,807,827	141,334,998
Securities available for sale	117,142,396	103,865,881
Loans, net of allowance for loan loss of $7,669,305 and $7,974,975 at September 30, 2013 and December 31, 2012, respectively	405,544,603	382,411,361
Bank premises and equipment, net	12,607,621	13,182,451
Other real estate owned	916,205	0
Interest receivable and other assets	23,173,299	19,786,065
	$ 659,191,951	$ 660,580,756
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits	$ 591,642,194	$ 586,992,650
Interest payable and other liabilities	4,170,838	3,619,382
Total liabilities	595,813,032	590,612,032
Commitments and contingencies		
Shareholders equity		
Series B Preferred stock, no par value; $1,000 per share liquidation preference, 10,000,000 shares authorized, 6,750 shares issued and outstanding at December 31, 2012	0	6,750,000
Common stock, no par value; 50,000,000 shares authorized, 7,929,730 and 7,907,780 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively	23,758,210	23,673,210
Additional paid-in capital	2,483,466	2,341,814
Retained earnings	38,070,279	33,958,737
Accumulated other comprehensive (loss) income, net of tax	(933,036)	3,244,963
Total shareholders equity	63,378,919	69,968,724
	$ 659,191,951	$ 660,580,756

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

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OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

FOR THE THREE AND NINE MONTH PERIODS ENDED SEPTEMBER 30, 2013 AND SEPTEMBER 30, 2012

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2013	2012	2013	2012
INTEREST INCOME				
Interest and fees on loans	$ 5,275,934	$ 5,633,389	$ 15,818,856	$ 16,934,021
Interest on securities available for sale	893,472	860,565	2,550,412	2,572,096
Interest on federal funds sold	5,315	6,568	17,012	16,192
Interest on deposits with banks	49,268	28,327	160,809	83,114
Total interest income	6,223,989	6,528,849	18,547,089	19,605,423
INTEREST EXPENSE				
Deposits	193,547	274,963	643,319	870,925
FHLB advances				4,707
Total interest expense	193,547	274,963	643,319	875,632
Net interest income	6,030,442	6,253,886	17,903,770	18,729,791
PROVISION FOR LOAN LOSSES	100,000	300,000	300,000	900,000
Net interest income after provision for loan losses	5,930,442	5,953,886	17,603,770	17,829,791
OTHER INCOME				
Service charges on deposits	318,064	287,101	903,599	868,677
Earnings on cash surrender value of life insurance	100,660	105,000	306,207	315,000
Mortgage commissions	59,944	63,792	196,646	171,579
Gains on called securities	18,091	35,406	52,656	70,410
Other	368,807	299,150	1,008,802	868,169
Total non-interest income	865,566	790,449	2,467,910	2,293,835
OTHER EXPENSES				
Salaries and employee benefits	2,451,037	2,462,468	7,590,178	7,552,214
Occupancy expenses	738,937	766,401	2,220,320	2,260,483
Data processing fees	330,603	282,347	938,206	838,211
OREO expenses	1,409		2,193	18,358
Regulatory assessments (FDIC & DFI)	120,000	114,000	360,000	347,000
Other operating expenses	976,444	901,973	2,880,486	2,719,706
Total non-interest expense	4,618,430	4,527,189	13,991,383	13,735,972
Net income before provision for income taxes	2,177,578	2,217,146	6,080,297	6,387,654
PROVISION FOR INCOME TAXES	672,358	738,315	1,901,255	2,095,958
NET INCOME	$ 1,505,220	$ 1,478,831	$ 4,179,042	$ 4,291,696
Preferred stock dividends		84,375	67,500	367,500
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$ 1,505,220	$ 1,394,456	$ 4,111,542	$ 3,924,196

NET INCOME PER COMMON SHARE	$ 0.19	$ 0.18	$ 0.53	$ 0.51
NET INCOME PER DILUTED COMMON SHARE	$ 0.19	$ 0.18	$ 0.52	$ 0.51

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

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OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME (UNAUDITED)

FOR THE THREE AND NINE MONTH PERIODS ENDED SEPTEMBER 30, 2013 AND SEPTEMBER 30, 2012

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2013	2012	2013	2012
Net income	$ 1,505,220	$ 1,478,831	$ 4,179,042	$ 4,291,696
Available for sale securities:				
Gross unrealized (loss) gain arising during the period	(2,762,108)	671,119	(7,046,747)	1,537,797
Reclassification adjustment for gains realized in net income (net of income tax of $7,444 and $21,668 for the three and nine months ended September 30, 2013, respectively and $14,570 and $28,974 for the comparable 2012 periods)	(10,647)	(20,836)	(30,988)	(41,436)
Income tax benefit (expense) related to unrealized gains/losses	1,136,608	(276,166)	2,899,736	(632,804)
Other comprehensive (loss) gain	(1,636,147)	374,117	(4,177,999)	863,557
Comprehensive (loss) income	$ (130,927)	$ 1,852,948	$ 1,043	$ 5,155,253

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

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OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

FOR THE YEAR ENDED DECEMBER 31, 2012 AND THE NINE-MONTH PERIOD ENDED SEPTEMBER 30, 2013 (UNAUDITED)

	YEAR ENDED DECEMBER 31, 2012 AND NINE MONTHS ENDED SEPTEMBER 30, 2013							
	Common Stock		Preferred Stock		Additional Paid-in		Accumulated Other	
	Shares	Amount	Shares	Amount	Capital	Retained Earnings	Comprehensive Income	Total Shareholders Equity
Balances, January 1, 2012	7,718,469	$ 23,453,443	13,500	$ 13,500,000	$ 2,128,700	$ 28,629,757	$ 2,690,106	$ 70,402,006
Stock options exercised	54,436	219,767						219,767
Tax benefit on stock options exercised					37,218			37,218
Restricted stock issued	134,875							
Repurchase of Series B preferred stock			(6,750)	$ (6,750,000)				(6,750,000)
Preferred stock dividend payments						(451,875)		(451,875)
Stock based compensation					175,896			175,896
Other comprehensive income							554,857	554,857
Net income						5,780,855		5,780,855
Balances, December 31, 2012	7,907,780	$ 23,673,210	6,750	$ 6,750,000	$ 2,341,814	$ 33,958,737	$ 3,244,963	$ 69,968,724
Stock options exercised	11,250	85,000						85,000
Restricted stock issued	15,000							
Restricted stock cancelled	(4,300)							
Repurchase of Series B preferred stock			(6,750)	$ (6,750,000)				(6,750,000)
Preferred stock dividend payments						(67,500)		(67,500)
Stock based compensation					141,652			141,652
Other comprehensive loss							(4,177,999)	(4,177,999)
Net income						4,179,042		4,179,042
Balances, September 30, 2013	7,929,730	$ 23,758,210	0	$ 0	$ 2,483,466	$ 38,070,279	$ (933,036)	$ 63,378,919

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

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OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE NINE MONTH PERIODS ENDED SEPTEMBER 30, 2013 AND SEPTEMBER 30, 2012

	NINE MONTHS ENDED SEPTEMBER 30,	
	2013	**2012**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 4,179,042	$ 4,291,696
Adjustments to reconcile net earnings to net cash from operating activities:		
Provision for loan losses	300,000	900,000
Increase (decrease) in deferred fees/costs, net	42,674	(81,575)
Depreciation	860,624	848,181
Amortization of investment securities, net	194,852	166,228
Stock based compensation	141,652	128,036
Excess tax benefits from stock-based payment arrangements	0	(37,218)
Loss (gain) on sale of premises and equipment	31,650	(22,498)
Gain on sale of OREO	(16,629)	(3,548)
Gain on called available for sale securities	(52,656)	(70,410)
Earnings on cash surrender value of life insurance	(306,207)	(315,000)
Increase in interest payable and other liabilities	551,456	3,092,985
Increase in interest receivable	(100,634)	(76,105)
Increase in other assets	(58,989)	(644,782)
Net cash from operating activities	5,766,835	8,175,990
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available for sale securities	(34,186,448)	(40,439,977)
Proceeds from maturities, calls, and principal paydowns of securities available for sale	13,668,334	25,174,459
Net (increase) decrease in loans	(25,357,546)	5,931,726
Purchase of FRB Stock	0	(1,450)
Redemption of FHLB stock	0	400,500
Proceeds from sale of OREO	982,054	247,923
Proceeds from sales of premises and equipment	5,625	22,498
Net purchases of premises and equipment	(323,069)	(453,125)
Net cash used in investing activities	(45,211,050)	(9,117,446)
CASH FLOWS FROM FINANCING ACTIVITIES:		
FHLB payments	0	(3,000,000)
Preferred stock dividend payment	(67,500)	(367,500)
Repurchase of Series B preferred stock	(6,750,000)	(6,750,000)
Net decrease in demand deposits and savings accounts	9,768,849	19,164,074
Net decrease in time deposits	(5,119,305)	(2,034,616)
Excess tax benefits from stock-based payment arrangements	0	37,218
Proceeds from sale of common stock and exercise of stock options	85,000	219,767
Net cash (used in) from financing activities	(2,082,956)	7,268,943
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(41,527,171)	6,327,487
CASH AND CASH EQUIVALENTS, beginning of period	141,334,998	101,084,775
CASH AND CASH EQUIVALENTS, end of period	$ 99,807,827	$ 107,412,262

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 653,682	$ 931,745
Income taxes	$ 1,520,000	$ 965,000
NON-CASH INVESTING ACTIVITIES:		
Real estate acquired through foreclosure	$ 1,881,630	$ 0
Change in unrealized (loss)/gain on available-for-sale securities	$ (7,099,403)	$ 1,467,387

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

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OAK VALLEY BANCORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION

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

The accounting principles followed by the Company and the methods of applying these principles conform with accounting principles generally accepted in the United States of America (GAAP) and with general practices within the banking industry. In preparing financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts in the financial statements. Actual results could differ significantly from those estimates. Material estimates common to the banking industry that are particularly susceptible to significant change in the near term include, but are not limited to, the determination of the allowance for loan losses, fair values of financial instruments, the estimation of compensation expense related to stock options granted to employees and directors, and valuation allowances associated with deferred tax assets, the recognition of which are based on future taxable income.

The interim consolidated financial statements included in this report are unaudited but reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the interim periods presented. All such adjustments are of a normal recurring nature. The results of operations for the three and nine month periods ended September 30, 2013 are not necessarily indicative of the results of a full year s operations. Certain prior year amounts have been reclassified to conform to the current year presentation. There was no effect on net income or shareholders equity. For further information, refer to the audited consolidated financial statements and footnotes included in the Company s Form 10-K for the year ended December 31, 2012.

NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS

In December 2011, the FASB issued ASU No. 2011-11, *Disclosures about Offsetting Assets and Liabilities.* The update requires an entity to offset, and present as a single net amount, a recognized eligible asset and a recognized eligible liability when it has an unconditional and legally enforceable right of setoff and intends either to settle the asset and liability on a net basis or to realize the asset and settle the liability simultaneously. The ASU requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The amendments are effective for annual and interim reporting periods beginning on or after January 1, 2013 and did not have a material impact on the Company s consolidated financial statements.

In January 2013, the FASB issued ASU No. 2013-01, *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. The Update clarifies that ASU. 2011-11 applies only to derivatives, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset or subject to an enforceable master netting arrangement or similar agreement. Entities with other types of financial assets and financial liabilities subject to a master netting arrangement or similar agreement are no longer subject to the disclosure requirements in ASU. 2011-11. The amendments are effective for

annual and interim reporting periods beginning on or after January 1, 2013 and did not have a material impact on the Company s consolidated financial statements.

In February 2013, the FASB issued ASU No. 2013-02*, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. The Update requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component and to present either on the face of the statement where net income is presented, or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2012 and did not have a material impact on the Company s consolidated financial statements.

In February 2013, the FASB issued ASU No. 2013-04, *Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date.* The Update requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, as the sum of the following: 1) The amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors, and 2) Any additional amount the reporting entity expects to pay on behalf of its co-obligors. The guidance in this Update also requires an entity to disclose the nature and amount of the obligation as well as other information about those obligations. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013, and are applied retrospectively to all prior periods presented for those obligations resulting from joint and several liability arrangements within the Update s scope that exist at the beginning of an entity s fiscal year of adoption. The adoption of ASU No. 2013-04 is not expected to have a material impact on the Company s consolidated financial statements.

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In July 2013, the FASB issued ASU No. 2013-10, *Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes*. ASU No. 2013-10 permits the use of the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge account purposes. The amendment is effective prospectively for qualifying new or redesiginated hedging relationships entered into on or after July 17, 2013. The adoption of ASU No. 2013-10 is not expected to have a material impact on the Company s consolidated financial statements

In July 2013, the FASB issued ASU No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. ASU No. 2013-11 requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except to the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. No new recurring disclosures are required. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2013 and are to be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. The adoption of ASU No. 2013-11 is not expected to have a material impact on the Company s consolidated financial statements.

NOTE 3 PREFERRED STOCK REPURCHASE AND WARRANT REDEMPTION

In August 2011, the Company repurchased the $13,500,000 of Series A Preferred Stock originally issued to the U.S. Treasury in December 2008 in connection with the Company s participation in the Capital Purchase Program (CPP). The Company simultaneously issued $13,500,000 in Series B Preferred Stock to the U.S. Treasury under the Small Business Lending Funding (SBLF) program. Subsequently, the Company fully redeemed a warrant to purchase 350,346 shares of its Common Stock, at the exercise price of $5.78 per share that the Company had granted to the U.S. Treasury pursuant to the CPP, for a purchase price of $560,000, which settled in September 2011.

In May 2012, the Company repurchased from the U.S. Treasury 6,750 shares of Series B Preferred Stock for aggregate consideration of $6.75 million. In March 2013, the Company repurchased the remaining 6,750 shares of Series B Preferred Stock for aggregate consideration of $6.75 million plus $67,500 for accrued interest. As of September 30, 2013, there are no outstanding shares of Series B Preferred Stock.

NOTE 4 SECURITIES

The amortized cost and estimated fair values of debt securities as of September 30, 2013 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. agencies	$ 52,622,388	$ 1,953,129	$ (1,264,298)	$ 53,311,218

Collateralized mortgage obligations	10,195,441	301,335	(68,859)	10,427,918
Municipalities	41,318,794	898,084	(3,379,578)	38,837,299
SBA Pools	1,102,217	0	(4,730)	1,097,487
Corporate debt	4,690,201	107,445	0	4,797,646
Asset Backed Securities	5,849,203	18,872	(19,555)	5,848,520
Mutual Fund	2,949,126	0	(126,819)	2,822,308
	$ 118,727,370	$ 3,278,865	$ (4,863,839)	$ 117,142,396

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The following tables detail the gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2013.

	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. agencies	$ 20,097,272	$ (1,015,959)	$ 1,747,229	$ (248,339)	$ 21,844,501	$ (1,264,298)
Collateralized mortgage obligations	1,672,944	(68,859)	0	0	1,672,944	(68,859)
Municipalities	26,848,775	(3,254,021)	1,024,109	(125,557)	27,872,884	(3,379,578)
SBA Pools	847,113	(3,598)	250,376	(1,132)	1,097,489	(4,730)
Corporate debt	0	0	0	0	0	0
Asset Backed Securities	3,899,340	(19,555)	0	0	3,899,340	(19,555)
Mutual Fund	2,822,308	(126,819)	0	0	2,822,308	(126,819)
Total temporarily impaired securities	$ 56,187,752	$ (4,488,811)	$ 3,021,714	$ (375,028)	$ 59,209,466	$ (4,863,839)

At September 30, 2013, there were two municipalities, one agency, and one SBA pool that comprised the total securities in an unrealized loss position for greater than 12 months and 12 agencies, 34 municipalities, 2 asset backed securities, one collateralized mortgage obligation, one mutual fund and one SBA pools that make up the total securities in a loss position for less than 12 months. Management periodically evaluates each available-for-sale investment security in an unrealized loss position to determine if the impairment is temporary or other than temporary. This evaluation encompasses various factors including, the nature of the investment, the cause of the impairment, the severity and duration of the impairment, credit ratings and other credit related factors such as third party guarantees and volatility of the security s fair value.Management has determined that no investment security is other than temporarily impaired. All of the temporarily impaired securities are credit rated as investment grade. The unrealized losses are due primarily to interest rate changes and the Company does not intend to sell the securities and it is not likely that we will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security.

The amortized cost and estimated fair value of debt securities at September 30, 2013, by contractual maturity or call date, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Available-for-sale securities:		
Due in one year or less	$ 14,884,900	$ 13,835,637
Due after one year through five years	20,467,867	21,497,654
Due after five years through ten years	43,203,072	41,259,614
Due after ten years	40,171,531	40,549,491
	$ 118,727,370	$ 117,142,396

The amortized cost and estimated fair values of debt securities as of December 31, 2012, are as follows:

	Fair Value

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Available-for-sale securities:				
U.S. agencies	$ 52,607,537	$ 2,949,355	$ (39,833)	$ 55,517,059
Collateralized mortgage obligations	11,698,399	905,985		12,604,384
Municipalities	25,323,157	1,727,206	(58,075)	26,992,288
SBA Pools	1,178,242	86	(20)	1,178,308
Corporate debt	4,669,390	37,048	(836)	4,705,602
Mutual Fund	2,874,727		(6,487)	2,868,240
	$ 98,351,452	$ 5,619,680	$ (105,251)	$ 103,865,881

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The following tables detail the gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2012.

	Less than 12 months		12 months or more		Total	
Description of Securities	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
U.S. agencies	$ 1,954,005	$ (39,833)	$	$	$ 1,954,005	$ (39,833)
Collateralized mortgage obligations						
Municipalities	3,088,970	(58,075)			3,088,970	(58,075)
SBA Pools			294,889	(20)	294,889	(20)
Corporate debt	749,164	(836)			749,164	(836)
Mutual Fund	2,493,512	(6,487)			2,493,512	(6,487)
Total temporarily impaired securities	$ 8,285,651	$ (105,231)	$ 294,889	$ (20)	$ 8,580,540	$ (105,251)

We recognized gross realized gains of approximately $18,000 and $53,000 for the three and nine month periods ended September 30, 2013, respectively, on certain available-for-sale securities that were partially called, which compares to approximately $35,000 and $70,000 in the same periods of 2012. There were no realized losses during 2013 and 2012 periods. There were no sales of available-for-sale securities during the first nine months of 2013 and 2012.

Securities carried at $75,240,000 and $56,484,000 at September 30, 2013 and December 31, 2012, respectively, were pledged to secure deposits of public funds.

NOTE 5 LOANS

Our customers are primarily located in Stanislaus, San Joaquin, Tuolumne, Inyo, and Mono Counties. As of September 30, 2013, approximately 81% of the Company s loans are commercial real estate loans which include construction loans. Approximately 11% of the Company s loans are for general commercial uses including professional, retail, and small business. Additionally, 5% of the Company s loans are for residential real estate and other consumer loans. The remaining 3% are agriculture loans. Loan totals were as follows:

	September 30, 2013	**December 31, 2012**
Commercial real estate:		
Commercial real estate- construction	$ 14,294,985	$ 6,581,854
Commercial real estate- mortgages	287,586,666	278,766,279
Land	11,027,837	14,269,477
Farmland	20,764,811	16,456,921
Commercial and industrial	44,994,021	36,528,505
Consumer	884,357	1,095,801
Consumer residential	23,212,516	25,659,090
Agriculture	11,091,240	11,628,260
Total loans	413,856,433	390,986,187

Less:				
Deferred loan fees and costs, net		(642,525)		(599,851)
Allowance for loan losses		(7,669,305)		(7,974,975)
Net loans	$	405,544,603	$	382,411,361

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

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

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company s commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Company s exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Company avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Company also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans. At September 30, 2013, commercial real estate loans equal to approximately 34.5% of the outstanding principal balance of our commercial real estate loans were secured by owner-occupied properties.

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

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

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

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

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Non-accrual loans, segregated by class of loans, were as follows:

	September 30, 2013	December 31, 2012
Commercial real estate:		
Commercial real estate- construction	$ 0	$ 126,427
Commercial real estate- mortgages	2,273,961	3,345,098
Land	1,188,002	2,419,223
Farmland	97,433	0
Commercial and industrial	18,919	21,311
Consumer	0	0
Consumer residential	0	1,010,998
Agriculture	0	0
Total non-accrual loans	$ 3,578,315	$ 6,923,057

Had non-accrual loans performed in accordance with their original contract terms, we would have recognized additional interest income of approximately $172,000 and $487,000 in three and nine month periods ended September 30, 2013, respectively, as compared to $178,000 and $514,000 in the same periods of 2012.

The following table analyzes past due loans including the non-accrual loans in the above table, segregated by class of loans, as of September 30, 2013:

September 30, 2013	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total	Greater Than 90 Days Past Due and Still Accruing
Commercial real estate:							
Commercial R.E. - construction	$ 0	$ 0	$ 0	$ 0	$ 14,294,985	$ 14,294,985	$ 0
Commercial R.E. - mortgages	0	1,227,478	1,046,483	2,273,961	285,312,705	287,586,666	0
Land	0	2,735,626	658,232	3,393,858	7,633,979	11,027,837	0
Farmland	0	0	97,433	97,433	20,667,378	20,764,811	0
Commercial and industrial	0	337,151	0	337,151	44,656,870	44,994,021	0
Consumer	120	0	0	120	884,237	884,357	0
Consumer residential	0	0	0	0	23,212,516	23,212,516	0
Agriculture	0	0	0	0	11,091,240	11,091,240	0
Total	$ 120	$ 4,300,255	$ 1,802,148	$ 6,102,523	$ 407,753,910	$ 413,856,433	$ 0

The following table analyzes past due loans including the non-accrual loans in the above table, segregated by class of loans, as of December 31, 2012:

December 31, 2012	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total	Greater Than 90 Days Past Due and Still

							Accruing
Commercial real estate:							
Commercial R.E. - construction	$ 0	$ 0	$ 126,427	$ 126,427	$ 6,455,427	$ 6,581,854	$ 0
Commercial R.E. - mortgages	55,089	623,118	2,386,688	3,064,895	275,701,384	278,766,279	0
Land	0	54,427	2,364,797	2,419,224	11,850,253	14,269,477	0
Farmland	0	0	0	0	16,456,921	16,456,921	0
Commercial and industrial	16,138	0	0	16,138	36,512,367	36,528,505	0
Consumer	0	0	0	0	1,095,801	1,095,801	0
Consumer residential	0	0	1,010,998	1,010,998	24,648,092	25,659,090	0
Agriculture	0	0	0	0	11,628,260	11,628,260	0
Total	$ 71,227	$ 677,545	$ 5,888,910	$ 6,637,682	$ 384,348,505	$ 390,986,187	$ 0

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Impaired Loans. Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. There was no interest income realized on impaired loans for the three and nine months ended September 30, 2013 and 2012. Average recorded investment in impaired loans was $2,970,000 and $4,484,000 for the three and nine months ended September 30, 2013, respectively, as compared to $6,898,000 and $6,727,000 for the same periods of 2012. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Impaired loans as of September 30, 2013 and December 31, 2012 are set forth in the following table. No interest income was recognized on impaired loans subsequent to their classification as impaired.

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
September 30, 2013						
Commercial real estate:						
Commercial R.E. - construction	$ 0	$ 0	$ 0	$ 0	$ 0	$ 68,603
Commercial R.E. - mortgages	4,636,774	2,273,961	0	2,273,961	0	2,086,389
Land	1,319,519	0	1,188,002	1,188,002	397,530	1,785,764
Farmland	98,913	97,433	0	97,433	0	50,409
Commercial and Industrial	27,305	18,919	0	18,919	0	20,199
Consumer	0	0	0	0	0	0
Consumer residential	0	0	0	0	0	472,166
Agriculture	0	0	0	0	0	
Total	$ 6,082,511	$ 2,390,313	$ 1,188,002	$ 3,578,315	$ 397,530	$ 4,483,530

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
December 31, 2012						
Commercial real estate:						
Commercial R.E. - construction	$ 193,027	$ 0	$ 126,427	$ 126,427	$ 2,872	$ 222,757
Commercial R.E. - mortgages	5,728,716	1,875,320	1,469,777	3,345,097	136,015	3,093,523
Land	6,866,869	663,232	1,755,991	2,419,223	409,656	2,833,250
Farmland	0	0	0	0	0	0
Commercial and Industrial	27,812	21,311	0	21,311	0	52,822
Consumer	0	0	0	0	0	0
Consumer residential	1,034,884	1,010,999	0	1,010,999	0	534,578
Agriculture	0	0	0	0	0	0
Total	$ 13,851,308	$ 3,570,862	$ 3,352,195	$ 6,923,057	$ 548,543	$ 6,736,930

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

performed under the Company s internal underwriting policy.

At September 30, 2013, there were 3 loans and leases that were considered to be troubled debt restructurings, all of which are considered non-accrual totaling $1,207,000. At December 31, 2012, there were 6 loans and leases that were considered to be troubled debt restructurings, all of which are considered non-accrual totaling $2,567,000. The decrease of three TDR loans during the first nine months of 2013 is due in part to a foreclosure on a loan totaling $54,000 that was subsequently sold. At December 31, 2012 there were unfunded commitments of $1,697,000, respectively, on one loan classified as a troubled debt restructure because of an agreement with a borrower to continue advancing funds and covering overhead costs on a residential development project. This loan and one other loan made to the same borrower totaling $1,303,000 were paid off during the second quarter of 2013. There were no unfunded commitments on TDR loans at September 30, 2013. We have allocated $398,000 and $413,000 of specific reserves to loans whose terms have been modified in troubled debt restructurings as of September 30, 2013 and December 31, 2012, respectively.

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During the three month periods ended September 30, 2013 and 2012, there were no loans modified as troubled debt restructuring. During the nine month period ended September 30, 2013, the terms of one loan were modified as troubled debt restructurings, and there were two loans modified as troubled debt restructuring in the comparable period of 2012. The modification of the terms of such loans typically includes one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date; or a temporary payment modification in which the payment amount allocated towards principal was reduced. In some cases, a permanent reduction of the accrued interest on the loan is conceded.

The following table presents loans by class modified as troubled debt restructurings that occurred during the nine month period ended September 30, 2013 and 2012:

	Nine Months Ended September 30, 2013			Nine Months Ended September 30, 2012		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial real estate:						
Commercial R.E. - construction	0	$ 0	$ 0	0	$ 0	$ 0
Commercial R.E. - mortgages	0	0	0	0	0	0
Land	1	541,594	541,594	1	58,261	58,261
Farmland	0	0	0	0	0	0
Commercial and Industrial	0	0	0	1	28,180	28,180
Consumer	0	0	0	0	0	0
Consumer residential	0	0	0	0	0	0
Agriculture	0	0	0	0	0	0
Total	1	$ 541,594	$ 541,594	2	$ 86,441	$ 86,441

The troubled debt restructuring during the nine months ended September 30, 2013 did not increase the allowance for loan losses as a result of loan modifications because the loans are evaluated as an impaired loan and a specific valuation allowance would have already been allocated, if necessary, prior to the loan modification. There were no charge-offs as a result of loan modifications, as the contractual balances outstanding were determined to be collectible.

The following table presents loans by class modified as troubled debt restructurings within the previous twelve months and for which there was a payment default during the nine month periods ended September 30, 2013 and 2012. None of these modified loans had a payment default during the three month periods ended September 30, 2013 and 2012.

	Nine Months Ended September 30, 2013		Nine Months Ended September 30, 2012	
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
Commercial real estate:				
Commercial R.E. - construction	0	0	1	$ 113,552
Commercial R.E. - mortgages	0	0	0	0

Land	1		54,427	1	1,197,418
Farmland	0		0	0	0
Commercial and Industrial	0		0	0	0
Consumer	0		0	0	0
Consumer residential	0		0	0	0
Agriculture	0		0	0	0
Total	1	$	54,427	2	$ 1,310,970

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

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

We grade loans using the following letter system:

1 Exceptional Loan

2 Quality Loan

3A Better Than Acceptable Loan

3B Acceptable Loan

3C Marginally Acceptable Loan

4 (W) Watch Acceptable Loan

5 Other Loans Especially Mentioned

6 Substandard Loan

7 Doubtful Loan

8 Loss

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

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

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

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

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

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

•Consistent strong earnings.

•A solid equity base.

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

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

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

•The loan has no exceptions to policy.

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

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

•Little to no debt on balance sheet.

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

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

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

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

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

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

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

- The lending officer may be unable to properly supervise the credit because of an inadequate loan or credit agreement.
- Questions exist regarding the condition of and/or control over collateral.
- Economic or market conditions may unfavorably affect the obligor in the future.
- A declining trend in the obligor s operations or an imbalanced position in the balance sheet exists, but not to the point that repayment is jeopardized.

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

7 Doubtful Loan - An extension of credit classified doubtful has all the weaknesses inherent in one classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high but because of certain important and reasonably specific pending factors that may work to the advantage of and strengthen the credit, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors may include a proposed merger or acquisition, liquidation proceedings, capital injection, perfecting liens on additional collateral or refinancing plans. The entire loan need not be classified doubtful when collection of a specific portion appears highly probable. An example of proper use of the doubtful category is the case of a company being liquidated, with the trustee-in-bankruptcy indicating a minimum disbursement of 40 percent and a maximum of 65 percent to unsecured creditors, including the Bank. In this situation, estimates are based on liquidation value appraisals with actual values yet to be realized. By definition, the only portion of the credit that is doubtful is the 25 percent difference between 40 and 65 percent.

A proper classification of such a credit would show 40 percent substandard, 25 percent doubtful, and 35 percent loss. A credit classified as doubtful should be resolved within a reasonable period of time. Reasonable is generally defined as the period between examinations. In other words, a credit classified doubtful at an examination should be cleared up before the next exam. However, there may be situations that warrant continuation of the doubtful classification a while longer.

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

As of September 30, 2013, there are no loans that are classified with a risk grade of *8- Loss.*

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

	September 30, 2013 Weighted Average Risk Grade	December 31, 2012 Weighted Average Risk Grade
Commercial real estate:		
Commercial real estate - construction	3.64	3.23
Commercial real estate - mortgages	3.15	3.22
Land	4.55	4.56
Farmland	3.01	3.04
Commercial and Industrial	3.00	3.09
Consumer	2.35	2.55
Consumer residential	3.02	3.17
Agriculture	3.28	3.50
Total gross loans	3.18	3.25

The following table presents risk grade totals by class of loans as of September 30, 2013 and December 31, 2012. Risk grades 1 through 4 have been aggregated in the Pass line.

Dollars in thousands	Commercial R.E. Construction	Commercial R.E. Mortgages	Land	Farmland	Commercial and Industrial	Consumer	Consumer Residential	Agriculture	Total
September 30, 2013									
Pass	$ 14,294,985	$ 278,632,256	$ 7,104,209	$ 20,667,378	$ 43,961,408	$ 867,858	$ 23,092,516	$ 11,091,240	$ 399,711,850
Special mention		3,799,906			265,272				4,065,178
Substandard		5,154,504	3,923,628	97,433	767,341	16,499	120,000		10,079,405
Doubtful									
Total loans	$ 14,294,985	$ 287,586,666	$ 11,027,837	$ 20,764,811	$ 44,994,021	$ 884,357	$ 23,212,516	$ 11,091,240	$ 413,856,433
December 31, 2012									
Pass	$ 6,455,427	$ 263,567,665	$ 8,974,864	$ 16,456,921	$ 35,435,491	$ 1,079,583	$ 24,257,465	$ 10,291,678	$ 366,519,094
Special mention		7,832,840			280,631			1,336,582	9,450,053
Substandard	126,427	7,365,774	5,294,613		812,383	16,218	1,401,625		15,017,040
Doubtful									
Total loans	$ 6,581,854	$ 278,766,279	$ 14,269,477	$ 16,456,921	$ 36,528,505	$ 1,095,801	$ 25,659,090	$ 11,628,260	$ 390,986,187

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

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

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

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

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

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

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

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

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The following table details activity in the allowance for loan losses by portfolio segment for the three and nine months ended September 30, 2013 and 2012. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

Allowance for Loan Losses

For the Three and Nine Months Ended September 30, 2013 and 2012

	Commercial Real Estate	Commercial and Industrial	Consumer	Consumer Residential	Agriculture	Unallocated	Total
Three Months Ended September 30, 2013							
Beginning balance	$ 6,375,872	$ 485,268	$ 42,443	$ 380,155	$ 186,120	$ 100,452	$ 7,570,310
Charge-offs	0	0	(3,595)	0	0	0	(3,595)
Recoveries	500	0	348	1,742	0	0	2,590
Provision	32,237	70,121	2,143	(45,537)	25,436	15,600	100,000
Ending balance	$ 6,408,609	$ 555,389	$ 41,339	$ 336,360	$ 211,556	$ 116,052	$ 7,669,305
Nine Months Ended September 30, 2013							
Beginning balance	$ 6,571,290	$ 473,727	$ 50,062	$ 383,653	$ 285,734	$ 210,509	$ 7,974,975
Charge-offs	(436,036)	0	(9,198)	(178,090)	0	0	(623,324)
Recoveries	8,235	0	2,827	6,592	0	0	17,654
Provision	265,120	81,662	(2,352)	124,205	(74,178)	(94,457)	300,000
Ending balance	$ 6,408,609	$ 555,389	$ 41,339	$ 336,360	$ 211,556	$ 116,052	$ 7,669,305
Three Months Ended September 30, 2012							
Beginning balance	$ 6,657,657	$ 409,740	$ 52,872	$ 506,991	$ 225,235	$ 155,453	$ 8,007,948
Charge-offs	(218,373)	0	(3,721)	(149,897)	0	0	(371,991)
Recoveries	6,207	0	1,071	10,242	0	0	17,520
Provision	70,979	75,526	1,070	38,452	23,142	90,831	300,000
Ending balance	$ 6,516,470	$ 485,266	$ 51,292	$ 405,788	$ 248,377	$ 246,284	$ 7,953,477
Nine Months Ended September 30, 2012							
Beginning balance	$ 6,969,004	$ 606,307	$ 65,060	$ 347,905	$ 363,174	$ 257,724	$ 8,609,174
Charge-offs	(1,428,713)	0	(24,372)	(149,897)	0	0	(1,602,982)
Recoveries	29,200	926	3,311	13,848	0	0	47,285
Provision	946,979	(121,967)	7,293	193,932	(114,797)	(11,440)	900,000
Ending balance	$ 6,516,470	$ 485,266	$ 51,292	$ 405,788	$ 248,377	$ 246,284	$ 7,953,477

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The following table details the allowance for loan losses and ending gross loan balances as of September 30, 2013 and December 31, 2012, summarized by collective and individual evaluation methods of impairment.

	Commercial Real Estate	Commercial and Industrial	Consumer	Consumer Residential	Agriculture	Unallocated	Total
September 30, 2013							
Allowance for loan losses for loans:							
Individually evaluated for impairment	$ 397,530	$ 0	$ 0	$ 0	$ 0	$ 0	$ 397,530
Collectively evaluated for impairment	6,011,079	555,389	41,339	336,360	211,556	116,052	7,271,775
	$ 6,408,609	$ 555,389	$ 41,339	$ 336,360	$ 211,556	$ 116,052	$ 7,669,305
Ending gross loan balances:							
Individually evaluated for impairment	$ 3,559,396	$ 18,919	$ 0	$ 0	$ 0	$ 0	$ 3,578,315
Collectively evaluated for impairment	330,114,903	44,975,102	884,357	23,212,516	11,091,240	0	410,278,118
	$ 333,674,299	$ 44,994,021	$ 884,357	$ 23,212,516	$ 11,091,240	$ 0	$ 413,856,433
December 31, 2012							
Allowance for loan losses for loans:							
Individually evaluated for impairment	$ 548,543	$ 0	$ 0	$ 0	$ 0	$ 0	$ 548,543
Collectively evaluated for impairment	6,022,747	473,727	50,062	383,653	285,734	210,509	7,426,432
	$ 6,571,290	$ 473,727	$ 50,062	$ 383,653	$ 285,734	$ 210,509	$ 7,974,975
Ending gross loan balances:							
Individually evaluated for impairment	$ 5,890,748	$ 21,311	$ 0	$ 1,010,998	$ 0	$ 0	$ 6,923,057
Collectively evaluated for impairment	310,183,783	36,507,194	1,095,801	24,648,092	11,628,260	0	384,063,130
	$ 316,074,531	$ 36,528,505	$ 1,095,801	$ 25,659,090	$ 11,628,260	$ 0	$ 390,986,187

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

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2013	2012	2013	2012
Balance, beginning of period	$ 121,524	$ 116,002	$ 108,209	$ 119,202
Provision (Recovery) to Operations for Off Balance Sheet Commitments	18,214	(11,127)	31,529	(14,327)
Balance, end of period	$ 139,738	$ 104,875	$ 139,738	$ 104,875

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

At September 30, 2013 and December 31, 2012, loans carried at $413,856,433 and $390,986,187, respectively, were pledged as collateral on advances from the Federal Home Loan Bank.

NOTE 6 OTHER REAL ESTATE OWNED

As of September 30, 2013, the Company owned three properties with outstanding balances of approximately $916,000, as compared to one property consisting of residential land that was written down to a zero balance that was classified as other real estate as of December 31, 2012. Each of these properties was acquired through loan foreclosure. The residential land property the Company owned at September 30, 2013 and December 31, 2012, was written down to a zero balance because the public utilities have not been obtainable rendering these land lots unmarketable at this time. There were two sales liquidating 8 OREO properties during the nine months ended September 30, 2013 resulting in a gain on sale of approximately $17,000, as compared to one sale recorded in the first nine months of 2012 that resulted in a gain on sale of approximately $4,000.

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

NOTE 7 OTHER POST-RETIREMENT BENEFIT PLANS

During January 2008, the Bank awarded certain officers a salary continuation plan (the Plan). Under the Plan, the participants will be provided with a fixed annual retirement benefit for twenty years after retirement. The Bank is also responsible for certain pre-retirement death benefits under the Plan. In connection with the implementation of the Plan, the Bank purchased single premium life insurance policies on the life of each of the officers covered under the Plan. The Bank is the owner and partial beneficiary of these life insurance policies. The assets of the Plan, under Internal Revenue Service regulations, are owned by the Bank and are available to satisfy the Company s general creditors.

During January 2008 the Bank awarded two of its directors a director retirement plan (DRP). Under the DRP, the participants will be provided with a fixed annual retirement benefit for ten years after retirement. The Bank is also responsible for certain pre-retirement death benefits under the DRP. In connection with the implementation of the DRP, the Bank purchased single premium life insurance policies on the life of each director covered under the DRP. The Bank is the owner and partial beneficiary of these life insurance policies. The assets of the DRP, under Internal Revenue Service regulations, are the property of the Bank and are available to satisfy the Bank s general creditors.

Future compensation under both plans is earned for services rendered through retirement. The Bank accrues for the salary continuation liability based on anticipated years of service and vesting schedules provided under the plans. The Bank s current benefit liability is determined based on vesting and the present value of the benefits at a corresponding discount rate. The discount rate used is an equivalent rate for investment-grade bonds with lives matching those of the service periods remaining for the salary continuation contracts, which average approximately 20 years. The salary continuation liability as of September 30, 2013 and December 31, 2012 was $1,973,000 and $1,800,000, respectively, and is reported in interest payable and other liabilities on the condensed consolidated balance sheets.

During January 2008, the Bank purchased $4.7 million in bank owned life insurance policies and entered into split-dollar life insurance agreements with certain officers and directors. In connection with the implementation of the split-dollar agreements, the Bank purchased single premium life insurance policies on the life of each of the officers and directors covered by the split-dollar life insurance agreements. The Bank is the owner of the policies and the partial beneficiary in an amount equal to the cash surrender value of the policies.

The combined cash surrender value of all Bank-owned life insurance policies recorded in other assets on the condensed consolidated balance sheet was $11,986,000 and $11,680,000 at September 30, 2013 and December 31, 2012, respectively.

NOTE 8 FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

Fair values of financial instruments The consolidated financial statements include various estimated fair value information as of September 30, 2013 and December 31, 2012. Such information, which pertains to the Company s financial instruments, does not purport to represent the aggregate net fair value of the Company. Further, the fair value estimates are based on various assumptions, methodologies, and subjective considerations, which vary widely among different financial institutions and which are subject to change.

Fair value measurements defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follow:

Level 1: Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstance that caused the transfer, which generally corresponds with the Company s quarterly valuation process.

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Following is a description of valuation methodologies used for assets and liabilities in the tables below:

Cash and cash equivalents The carrying amounts of cash and cash equivalents approximate their fair value and are considered a level 1 valuation.

Restricted Equity Securities- The carrying amounts of the stock the Company s owns in FRB and FHLB approximate their fair value and are considered a level 2 valuation.

Loans receivable For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. The fair values for other loans (e.g., real estate construction and mortgage, commercial, and installment loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The allowance for loan losses is considered to be a reasonable estimate of loan discount due to credit risks. The Company s fair value model takes into account many inputs including current market rates on new loans, the U.S. treasury yield curve, LIBOR yield curve, rate floors, rate ceilings, remaining maturity, and average life based on specific loan type. Net loans are considered to be a level 3 valuation.

Deposit liabilities The fair values estimated for demand deposits (interest and non-interest checking, savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). The carrying amounts for variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of the aggregate expected monthly maturities on time deposits. The fair value of deposits is determined by the Company s internal assets and liabilities modeling system that accounts for various inputs such as decay rates, rate floors, FHLB yield curve, maturities and current rates offered on new accounts. Fair value on deposits is considered a level 3 valuation.

Interest receivable and payable - The carrying amounts of accrued interest approximate their fair value and are considered to be a level 2 valuation.

Off-balance-sheet instruments Fair values for the Bank s off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the credit standing of the counterparties. The Company considers the Bank s off balance sheet instruments to be a level 3 valuation.

The estimated fair values of the Company s financial instruments at September 30, 2013 were as follows:

	Carrying Amount	Fair Value	Hierarchy Valuation Level
Financial assets:			

Cash and cash equivalents	$ 99,807,827	$ 99,807,827	1
Restricted equity securities	3,170,250	3,170,250	2
Loans, net	405,544,603	420,202,001	3
Interest receivable	1,755,110	1,755,110	2
Financial liabilities:			
Deposits	(591,642,194)	(578,619,845)	3
Interest payable	(57,595)	(57,595)	2
Off-balance-sheet assets (liabilities):			
Commitments and standby letters of credit		(550,057)	3

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The estimated fair values of the Company s financial instruments at December 31, 2012 were as follows:

	Carrying Amount	Fair Value	Hierarchy Valuation Level
Financial assets:			
Cash and cash equivalents	$ 141,334,998	$ 141,334,998	1
Restricted equity securities	3,129,750	3,129,750	2
Loans, net	382,411,361	398,029,908	3
Interest receivable	1,654,474	1,654,474	2
Financial liabilities:			
Deposits	(586,992,650)	(587,430,712)	3
Interest payable	(67,958)	(67,958)	2
Off-balance-sheet assets (liabilities):			
Commitments and standby letters of credit		(422,036)	3

The following table presents the carrying value of recurring and nonrecurring financial instruments that were measured at fair value and that were still held in the statements of condition at each respective period end, by level within the fair value hierarchy as of September 30, 2013 and December 31, 2012.

		Fair Value Measurements at September 30, 2013 Using		
	September 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets and liabilities measured on a recurring basis:				
Available-for-sale securities:				
U.S. agencies	$ 53,311,218	$ 0	$ 53,311,218	$ 0
Collateralized mortgage obligations	10,427,918	0	10,427,918	0
Municipalities	38,837,299	0	38,837,299	0
SBA Pools	1,097,487	0	1,097,487	0
Corporate Debt	4,797,646	0	4,797,646	0
Asset backed securities	5,848,520	0	5,848,520	
Mutual Fund	2,822,308	2,822,308	0	0
Assets and liabilities measured on a non-recurring basis:				
Impaired loans:				
Land	$ 1,188,002	0	0	$ 1,188,002
Other real estate owned	$ 916,205	$ 0	$ 0	$ 916,205

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	December 31, 2012	Fair Value Measurements at December 31, 2012 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets and liabilities measured on a recurring basis:				
Available-for-sale securities				
U.S. agencies	$ 55,517,059	$ 0	$ 55,517,059	$ 0
Collateralized mortgage obligations	12,604,384	0	12,604,384	0
Municipalities	26,992,288	0	26,992,288	0
SBA Pools	1,178,308	0	1,178,308	0
Corporate debt	4,705,602	0	4,705,602	0
Mutual Fund	2,868,240	2,868,240	0	0
Assets and liabilities measured on a non-recurring basis:				
Impaired Loans:				
Commercial real estate- construction	126,427	$ 0	$ 0	$ 426,427
Commercial real estate- mortgages	3,097,923	$ 0	$ 0	$ 3,097,923
Land	1,755,991	$ 0	$ 0	$ 1,755,991

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

Available-for-sale securities - Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, if available. If quoted market prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security s credit rating, prepayment assumptions, and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets where significant inputs are unobservable.

Impaired loans - ASC Topic 820 applies to loans measured for impairment using the practical expedients permitted by ASC Topic 310, *Accounting by Creditors for Impairment of a Loan*. The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Impaired loans where an allowance is established based on the fair value of collateral less the cost related to liquidation of the collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as non-recurring Level 3. Likewise, when an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as non-recurring Level 3.

Other Real Estate Owned - Other real estate assets (OREO) acquired through, or in lieu of, foreclosure are held-for-sale and are initially recorded at the lower of cost or fair value, less selling costs. Any write-downs to fair value at the time of transfer to OREO are charged to the allowance for loan losses, subsequent to foreclosure. Appraisals or evaluations are then done periodically thereafter charging any additional write-downs or valuation allowances to the appropriate expense accounts. Values are derived from appraisals of underlying collateral and discounted cash flow analysis. OREO is classified within Level 3 of the hierarchy.

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

There have been no significant changes in the valuation techniques during the periods ended September 30, 2013.

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NOTE 9 EARNINGS PER SHARE

Earnings per share (EPS) are based upon the weighted average number of common shares outstanding during each year. The following table shows: (1) weighted average basic shares, (2) effect of dilutive securities related to stock options and non-vested restricted stock, and (3) weighted average shares of common stock and common stock equivalents. Net income available to common stockholders is calculated as net income reduced by dividends accumulated on preferred stock. Basic EPS are calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during each period, excluding unvested restricted stock awards. Diluted EPS are calculated using the weighted average diluted shares, which reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The dilutive shares included in year-to-date diluted EPS is a weighted average of the dilutive shares included in each quarterly diluted EPS computation under the treasury stock method. We have two forms of outstanding common stock: common stock and unvested restricted stock awards. Holders of restricted stock awards receive non-forfeitable dividends at the same rate as common stockholders and they both share equally in undistributed earnings.

The Company s calculation of basic and diluted earnings per share (EPS) for the three and nine month periods ended September 30, 2013 and 2012 are reflected in the table below.

In thousands (except share and per share amounts)	THREE MONTHS ENDED SEPTEMBER 30, 2013	2012
BASIC EARNINGS PER SHARE		
Net income available to common shareholders	$ 1,505,220	$ 1,394,456
Weighted average shares outstanding	7,802,705	7,750,727
Net income per common share	$ 0.19	$ 0.18
DILUTED EARNINGS PER SHARE		
Net income available to common shareholders	$ 1,505,220	$ 1,394,456
Weighted average shares outstanding	7,802,705	7,750,727
Effect of dilutive stock options	8,397	6,917
Effect of dilutive non-vested restricted shares	40,055	20,502
Weighted average shares of common stock and common stock equivalents	7,851,157	7,778,146
Net income per diluted common share	$ 0.19	$ 0.18

In thousands (except share and per share amounts)	NINE MONTHS ENDED SEPTEMBER 30, 2013	2012
BASIC EARNINGS PER SHARE		
Net income available to common shareholders	$ 4,111,542	$ 3,924,196
Weighted average shares outstanding	7,794,439	7,733,848
Net income per common share	$ 0.53	$ 0.51
DILUTED EARNINGS PER SHARE		
Net income available to common shareholders	$ 4,111,542	$ 3,924,196
Weighted average shares outstanding	7,794,439	7,733,848
Effect of dilutive stock options	10,428	11,934

Effect of dilutive non-vested restricted shares		36,729		11,972
Weighted average shares of common stock and common stock equivalents		7,841,596		7,757,754
Net income per diluted common share	$	0.52	$	0.51

During the three and nine month periods ended September 30, 2013, anti-dilutive weighted average options to purchase 69,500 and 71,313 shares of common stock, respectively, were outstanding with prices ranging from $8.25 to $15.67. Anti-dilutive weighted average stock options of 202,750 and 208,375 were outstanding during the three and nine month periods of 2012, respectively, with prices ranging from $7.04 to $15.67. These options were not included in the computation of diluted EPS because the options exercise price was greater than the average market price of the common shares. These options begin to expire in 2015.

There were no anti-dilutive non-vested restricted stock grants for the three and nine months ended September 30, 2013 and 2012.

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

The following discussion explains the significant factors affecting our operations and financial position for the periods presented. The discussion should be read in conjunction with our financial statements and the notes related thereto which appear or that are referenced to elsewhere in this report, and with the audited consolidated financial statements and accompanying notes included in our 2012 Annual Report on Form 10-K, as amended. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances.

The discussion and analysis of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions. This discussion and analysis includes executive management s (Management) insight of the Company s financial condition and results of operations of Oak Valley Bancorp and its subsidiary. Unless otherwise stated, the Company refers to the consolidated entity, Oak Valley Bancorp, while the Bank refers to Oak Valley Community Bank.

Forward-Looking Statements

Some matters discussed in this Form 10-Q may be forward-looking statements within the meaning of the Private Litigation Reform Act of 1995 and therefore may involve risks, uncertainties and other factors which may cause our actual results to be materially different from the results expressed or implied by our forward-looking statements. These statements generally appear with words such as anticipate, believe, estimate, may, intend, and expect. Although management believes that the assumptions and expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to be correct. Factors that could cause actual results to differ from results discussed in forward-looking statements include, but are not limited to: economic conditions (both generally and in the markets where the Company operates); competition from other providers of financial services offered by the Company; changes in government regulation and legislation; changes in interest rates; material unforeseen changes in the financial stability and liquidity of the Company s credit customers; risks associated with concentrations in real estate related loans; changes in accounting standards and interpretations; and other risks as may be detailed from time to time in the Company s filings with the Securities and Exchange Commission, all of which are difficult to predict and which may be beyond the control of the Company or the Company. The Company undertakes no obligation to revise forward-looking statements to reflect events or changes after the date of this discussion or to reflect the occurrence of unanticipated events.

Forward-looking statements speak only as of the date they are made, and the Company does not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made, whether as a result of new information, future developments or otherwise, except as may be required by law.

Critical Accounting Estimates

Management has determined the following five accounting policies to be critical:

Asset Impairment Judgments

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

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

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

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Allowance for Loan Losses

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

We base our allowance for loan losses on an estimation of probable losses inherent in our loan portfolio. Our methodology for assessing loan loss allowances are intended to reduce the differences between estimated and actual losses and involves a detailed analysis of our loan portfolio in three phases:

- the specific review of individual loans,

- the segmenting and review of loan pools with similar characteristics, and

- our judgmental estimate based on various subjective factors.

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

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

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

- concentration of credits,

- nature and volume of the loan portfolio,

- delinquency trends,

- non-accrual loan trend,

- problem loan trend,

- loss and recovery trend,

- quality of loan review,

- lending and management staff,

- lending policies and procedures,

- economic and business conditions, and

- other external factors, including regulatory review.

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

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

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Non-Accrual Loan Policy

Interest on loans is credited to income as earned and is accrued only if deemed collectible. Accrual of interest is discontinued when a loan is over 90 days delinquent or if management believes that collection is highly uncertain. Generally, payments received on non-accrual loans are recorded as principal reductions. Interest income is recognized after all principal has been repaid or an improvement in the condition of the loan has occurred that would warrant resumption of interest accruals. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due.

Stock-Based Compensation

The Company recognizes in the consolidated statements of income the grant-date fair value of stock options and other equity-based forms of compensation issued to employees over the employees requisite service period (generally the vesting period). The Company uses the straight-line recognition of expenses for awards with graded vesting. The Company utilizes a binomial pricing model for all grants. Expected volatility is based on the historical volatility of the price of the Company s stock for the period equal to the contractual stock option term. The Company uses historical data to estimate option exercise and stock option forfeiture rates within the valuation model. The expected term of options granted for the binomial model is derived from applying a historical suboptimal exercise factor to the contractual term of the grant. For binomial pricing, the risk-free rate for periods is equal to the U.S. Treasury yield at the time of grant and commensurate with the contractual term of the grant. Compensation expense for restricted stock awards is determined by the market value of the shares awarded on the grant date straight lined over the vesting period.

Other Real Estate Owned

Other real estate owned, which represents real estate acquired through foreclosure, or deed in lieu of foreclosure in satisfaction of commercial and real estate loans, is carried at the lower of cost or estimated fair value less the estimated selling costs of the real estate. The fair value of the property is based upon a current appraisal. The difference between the fair value of the real estate collateral and the loan balance at the time of transfer is recorded as a loan charge-off if fair value is lower. Subsequent to foreclosure, management periodically performs valuations and the OREO property is carried at the lower of carrying value or fair value, less costs to sell. The determination of a property s estimated fair value incorporates (1) revenues projected to be realized from disposal of the property, (2) construction and renovation costs, (3) marketing and transaction costs, and (4) holding costs (e.g., property taxes, insurance and homeowners association dues). Any subsequent declines in the fair value of the OREO property after the date of transfer are recorded through a write-down of the asset. Any subsequent operating expenses or income, reduction in estimated fair values, and gains or losses on disposition of such properties are charged or credited to current operations.

Introduction

Oak Valley Community Bank commenced operations in May 1991. We are an insured bank under the Federal Deposit Insurance Act and are a member of the Federal Reserve. Since its formation, the Bank has provided basic banking services to individuals and business enterprises in Oakdale, California and the surrounding areas. The focus of the Bank is to offer a range of commercial banking services designed for both individuals and small to medium-sized businesses in the two main areas of service of the Company: the Central Valley and the Eastern Sierras.

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

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

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

Overview of Results of Operations and Financial Condition

The purpose of this summary is to provide an overview of the items management focuses on when evaluating the condition of the Company and its success in implementing its business and shareholder value strategies. The Company s business strategy is to operate the Bank as a well-capitalized, profitable and independent community oriented bank. The Company s shareholder value strategy has three major themes: (1) enhancing shareholder value; (2) making its retail banking franchise more valuable; and (3) efficiently utilizing its capital.

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Management believes the following were important factors in the Company s performance during the three and nine month periods ended September 30, 2013:

- Thanks to our deep roots in the communities that we serve, our focus on customer care and our selectivity in lending, during the first nine months of 2013, our performance has been better than most institutions of our size that compete in our market. Despite the stagnant economy affecting our primary market areas, we have been able to increase our core deposits to $580.2 million and have posted net income available to common shareholders of $0.19 and $0.52 per diluted share for the three and nine month periods ended September 30, 2013, respectively. While recently published economic data indicates that the current downturn may be easing, it is not clear when or at what speed the economy will recover. To the extent that the weak business climate continues, it will affect the market areas that we serve and our results accordingly.

- The Company recognized net income available to common shareholders of $1,505,000 and $4,112,000 for the three and nine month periods ended September 30, 2013, respectively, as compared to $1,394,000 and $3,924,000 for the same periods in 2012. The Company recognized net income before preferred stock dividends of $1,505,000 and $4,179,000 for the three and nine months ended September 30, 2013, respectively, as compared to $1,479,000 and $4,292,000 for the same periods in 2012. The factors contributing to these results will be discussed below.

- The Company recognized $68,000 in the nine months ended September 30, 2013, associated with the accrual for preferred stock dividends for the Series B Preferred Stock that the U.S. Treasury owned under the Small Business Lending Fund (SBLF). The Company repurchased 6,750 shares of its Series B Preferred Stock in May 2012, and 6,750 shares of its Series B Preferred Stock in March 2013, leaving no shares of Series B Preferred Stock outstanding as of March 31, 2013. In comparison, the three and nine month periods of 2012 reflected $85,000 and $368,000, respectively, for preferred stock dividends.

- The Company has taken significant steps to reduce the risk of loan losses. In the three and nine month periods ended September 30, 2013, the provision for loan loss was $100,000 and $300,000, respectively, which compares to $300,000 and $900,000 recorded in the same periods in 2012. The decrease was mainly due to management s assessment of the appropriate level for the allowance for loan losses and a decrease in the level of non-accrual loans. The Company continues to monitor the Bank s loan portfolio with the objective of avoiding defaults or write-downs. Despite these actions, the possibility of additional losses cannot be eliminated, but the Board of Directors and all employees continue to work hard to make the best of these continuing challenging conditions.

- Net interest income decreased $224,000 or 3.6% and $826,000 or 4.4% for the three and nine month periods ended September 30, 2013, respectively, compared to the same periods in 2012. The decrease was primarily due to loan and investment security yield reduction.

- Non-interest income increased by $75,000 or 9.5% and $174,000 or 7.6% for the three and nine months ended September 30, 2013, respectively, as compared to the same periods in 2012. The increase was primarily due to increased investment service fee income and mortgage commissions.

- Non-interest expense increased by $91,000 or 2.0% and $255,000 or 1.9% for the three and nine month periods ended September 30, 2013, respectively, as compared to the same periods in 2012. The increase was due to a combination of expenses incurred to support the growth of our product lines and services, which was offset in part by strong loan production resulting in an increase in deferred loan cost of $238,000, for the nine month period of 2013 compared to 2012, included in salaries and employee benefits.

- Total assets decreased $1.4 million or 0.2% from December 31, 2012. Total net loans increased by $23.1 million or 6.0% and investment securities increased by $13.3 million or 12.8% from December 31, 2012 to September 30, 2013, while deposits increased by $4.6 million or 0.8% for the same period.

Income Summary

For the three and nine month periods ended September 30, 2013, the Company recorded net income available to common shareholders of $1,505,000 and $4,112,000, respectively, representing increases of $111,000 and $187,000, as compared to the same periods in 2012. Return on average assets (annualized) was 0.92% and 0.87% for the three and nine months ended September 30, 2013, respectively, as compared with 0.97% and 0.96% for the same periods in 2012. Annualized return on average common equity was 9.45% and 8.59% for the three and nine months ended September 30, 2013, respectively, as compared to 9.02% and 8.78% for the same periods of 2012.

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Net income before provisions for income taxes and preferred stock dividends and accretion was down $40,000 and $307,000 for the third quarter and nine months ended September 30, 2013, respectively, from the comparable 2012 periods. The income statement components of these variances are as follows:

Pre-Tax Income Variance Summary:

(In thousands)	Effect on Pre-Tax Income Increase (Decrease) Three Months Ended September 30, 2013	Effect on Pre-Tax Income Increase (Decrease) Nine Months Ended September 30, 2013
Change from 2012 to 2013 in:		
Net interest income	$ (224)	$ (826)
Provision for loan losses	200	600
Non-interest income	75	174
Non-interest expense	(91)	(255)
Change in income before income taxes	$ (40)	$ (307)

These variances will be explained in the discussion below.

Net Interest Income

Net interest income is the largest source of the Company s operating income. For the three and nine month periods ended September 30, 2013, net interest income was $6.0 million and $17.9 million, respectively, which represented decreases of $224,000 or 3.6% and $826,000 or 4.4% from the comparable periods in 2012.

The net interest margin (net interest income as a percentage of average interest earning assets) was 4.12% and 4.11% for the three and nine month periods ended September 30, 2013, respectively, a decrease of 45 and 55 basis points, as compared to the same periods in 2012. The decrease in the net interest margin in the first nine months of 2013 was primarily attributable to a change in the mix of earning assets with a higher portion in investment securities and interest earning deposits balances, which had average balance increases of $13.6 million and $37.1 million, respectively, compared to the first nine months of 2012. These balances had yields of 3.54% and 0.26%, respectively, in the first nine months of 2013, which was significantly less than the yield on gross loans and thus driving down the overall yield on earning assets.

The current low market interest rate environment has had a positive impact on net interest income in previous years because the Company s balance sheet is liability sensitive which typically results in our average cost of funds decreasing faster than the average yield on interest earning assets in a declining rate environment. In 2013, we have not recognized this benefit to the same degree, as deposit interest rates are at historic lows and have essentially reached a threshold in which they cannot reasonably be further reduced. However, the total cost of funds did recognize a moderate decrease of 9 basis points for the three and nine months ended September 30, 2013, respectively, compared to 2012 due to further rate reductions and a shift from high cost CDs and FHLB borrowed funds into demand deposit and money market accounts. In addition, average non-interest-bearing demand deposit balances increased by $22.9 million and $31.0 million for the three and nine month periods ended September 30, 2013, respectively, as compared to the same periods of 2012. Compared to cost of funds, the decrease in earning asset yield was

more significant at 53 and 61 basis points for the three and nine month periods ended September 30, 2013, respectively, compared to the same periods of 2012. The investment securities portfolio recognized a significant decrease of 76 and 31 basis points for the third quarter and nine month period of 2013, respectively, as compared to 2012, mainly because of the Company deploying cash into investment security purchases, which have historically low yields. The yield on loans decreased moderately by 32 and 37 basis points for the third quarter and nine month period of 2013, respectively, as compared to 2012, in spite the significant portion of our loans that are at their contractual rate floors.

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The following tables shows the relative impact of changes in average balances of interest earning assets and interest bearing liabilities, and interest rates earned and paid by the Company on those assets and liabilities for the three and nine month periods ended September 30, 2013 and 2012:

Net Interest Analysis

	Three Months Ended September 30, 2013			Three Months Ended September 30, 2012		
(Dollars in thousands)	**Average Balance**	**Interest Income / Expense**	**Avg Rate/ Yield**	**Average Balance**	**Interest Income / Expense**	**Avg Rate/ Yield**
Assets:						
Earning assets:						
Gross loans (1) (2)	$ 398,490	$ 5,442	5.42%	$ 389,868	$ 5,636	5.74%
Investment securities (2)	119,768	896	2.97%	102,847	967	3.73%
Federal funds sold	9,042	5	0.22%	11,174	7	0.25%
Interest-earning deposits	70,236	49	0.28%	48,105	28	0.23%
Total interest-earning assets	597,536	6,392	4.24%	551,994	6,638	4.77%
Total noninterest earning assets	48,493			54,078		
Total Assets	646,029			606,072		
Liabilities and Shareholders Equity:						
Interest-bearing liabilities:						
Interest-earning DDA	14,257	4	0.11%	232	0	0.00%
Money market deposits	234,430	72	0.12%	247,865	124	0.20%
NOW deposits	82,824	19	0.09%	67,428	27	0.16%
Savings deposits	37,554	14	0.15%	27,189	15	0.22%
Time certificates of deposit $100,000 or more	34,207	62	0.72%	37,563	80	0.84%
Other time deposits	19,449	23	0.47%	20,988	29	0.55%
Other borrowings	0	0	0.00%	0	0	0.00%
Total interest-bearing liabilities	422,721	194	0.18%	401,265	275	0.27%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	156,314			133,457		
Other liabilities	3,827			3,282		
Total noninterest-bearing liabilities	160,141			136,739		
Shareholders equity	63,167			68,068		
Total liabilities and shareholders equity	$ 646,029			$ 606,072		
Net interest income		$ 6,198			$ 6,363	
Net interest spread (3)			4.06%			4.50%
Net interest margin (4)			4.12%			4.57%

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

(2) Yields and interest income on municipal securities and loans have been adjusted to their fully-taxable equivalents, based on a federal marginal tax rate of 34.0%.

(3) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

(4) Represents net interest income as a percentage of average interest-earning assets.

(5) Annual interest rates are computed by dividing the interest income/expense by the number of days in the period multiplied by 365.

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(Dollars in thousands)	Nine months ended September 30, 2013 Average Balance	Interest Income / Expense	Avg Rate/ Yield	Nine months ended September 30, 2012 Average Balance	Interest Income / Expense	Avg Rate/ Yield
Assets:						
Earning assets:						
Gross loans (1) (2)	$ 391,587	$ 15,824	5.40%	$ 391,036	$ 16,943	5.77%
Investment securities (2)	112,685	2,983	3.54%	99,065	2,864	3.85%
Federal funds sold	9,792	17	0.23%	9,453	16	0.23%
Interest-earning deposits	82,003	161	0.26%	44,919	83	0.25%
Total interest-earning assets	596,067	18,985	4.26%	544,473	19,906	4.87%
Total noninterest earning assets	49,181			53,385		
Total Assets	645,248			597,858		
Liabilities and Shareholders Equity:						
Interest-bearing liabilities:						
Interest-earning DDA	10,376	10	0.13%	106		0.00%
Money market deposits	239,325	251	0.14%	250,649	401	0.21%
NOW deposits	80,478	63	0.10%	65,765	78	0.16%
Savings deposits	35,170	41	0.16%	25,832	45	0.23%
Time certificates of deposit $100,000 or more	36,321	206	0.76%	37,125	244	0.88%
Other time deposits	19,750	72	0.49%	22,093	103	0.62%
Other borrowings	0	0	0.00%	624	5	1.07%
Total interest-bearing liabilities	421,420	643	0.20%	402,194	876	0.29%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	154,297			123,300		
Other liabilities	3,768			3,018		
Total noninterest-bearing liabilities	158,065			126,318		
Shareholders equity	65,763			69,346		
Total liabilities and shareholders equity	$ 645,248			$ 597,858		
Net interest income		$ 18,342			$ 19,030	
Net interest spread (3)			4.06%			4.58%
Net interest margin (4)			4.11%			4.66%

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

(2) Yields and interest income on municipal securities and loans have been adjusted to their fully-taxable equivalents, based on a federal marginal tax rate of 34.0%.

(3) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

(4) Represents net interest income as a percentage of average interest-earning assets.

(5) Annual interest rates are computed by dividing the interest income/expense by the number of days in the period multiplied by 365.

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Shown in the following tables are the relative impacts on net interest income of changes in the average outstanding balances (volume) of earning assets and interest bearing liabilities and the rates earned and paid by the Company on those assets and liabilities for the three and nine month periods ended September 30, 2013 and 2012. Changes in interest income and expense that are not attributable specifically to either rate or volume are allocated to the rate column below.

Rate / Volume Variance Analysis

(In thousands)

	For the Three Months Ended September 30, 2013 vs 2012 Increase (Decrease) in interest income and expense due to changes in:		
	Volume	**Rate**	**Total**
Interest income:			
Gross loans (1) (2)	$ 125	$ (319)	$ (194)
Investment securities (2)	159	(230)	(71)
Federal funds sold	(1)	(1)	(2)
Interest-earning deposits	13	8	21
Total interest income	$ **296**	$ **(542)**	$ **(246)**
Interest expense:			
Interest-earning DDA	0	4	4
Money market deposits	(7)	(45)	(52)
NOW deposits	6	(14)	(8)
Savings deposits	6	(7)	(1)
Time CD $100K or more	(7)	(11)	(18)
Other time deposits	(2)	(4)	(6)
Other borrowings	0	0	0
Total interest expense	$ **(4)**	$ **(77)**	$ **(81)**
Change in net interest income	$ **300**	$ **(465)**	$ **(165)**

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

(2) Interest income on municipal securities and loans has been adjusted to their fully-taxable equivalents, based on a federal marginal tax rate of 34.0%.

The table above reflects the current low interest rate environment has impacted assets more than liabilities as indicated by the decrease of $465,000 in net interest income due to the rate change for the third quarter of 2013. This is not typical for the Company, as we have historically been liability sensitive in recent years. However, purchases of investment securities in the past 12 months at market interest rates lower than our overall portfolio reflects a decrease of $230,000 due to the lower yield of the new securities. Additionally, the decrease in loan yields resulted in a $319,000 decrease to loan interest income for the quarter compared to prior year. The increase in earning asset balances combined with the overall change in mix of balances resulted in an increase of $300,000 to net interest income over the same period.

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	For the Nine Months Ended September 30, 2013 vs 2012 Increase (Decrease) in interest income and expense due to changes in:		
	Volume	Rate	Total
Interest income:			
Gross loans (1) (2)	$ 24	$ (1,143)	$ (1,119)
Investment securities (2)	394	(275)	119
Federal funds sold	1	0	1
Interest-earning deposits	69	9	78
Total interest income	$ **488**	$ **(1,409)**	$ **(921)**
Interest expense:			
Interest-earning DDA	0	10	10
Money market deposits	(18)	(132)	(150)
NOW deposits	17	(32)	(15)
Savings deposits	16	(20)	(4)
Time CD $100K or more	(5)	(33)	(38)
Other time deposits	(11)	(20)	(31)
Other borrowings	(5)	0	(5)
Total interest expense	$ **(6)**	$ **(227)**	$ **(233)**
Change in net interest income	$ **494**	$ **(1,182)**	$ **(688)**

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

(2) Interest income on municipal securities and loans has been adjusted to their fully-taxable equivalents, based on a federal marginal tax rate of 34.0%.

The table above reflects the current low interest rate environment has impacted assets more than liabilities as indicated by the decrease of $1,182,000 in net interest income due to the rate change for the first nine months of 2013. This is not typical for the Company, as we have historically been liability sensitive in recent years. However, purchases of investment securities in the past 12 months at market interest rates lower than our overall portfolio reflects a decrease of $275,000 due to the lower yield of the new securities. Additionally, the decrease in loan yields resulted in a $1,143,000 year-to-date decrease to loan interest income compared to prior year. The increase in earning asset balances combined with the overall change in mix of balances resulted in an increase of $494,000 to net interest income over the same period.

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Non-Interest Income

Non-interest income represents service charges on deposit accounts and other non-interest related charges and fees, including fees from mortgage commissions and investment service fee income. For the three and nine month periods ended September 30, 2013, non-interest income was $866,000 and $2,468,000, respectively, representing increases of $75,000 or 9.5% and $174,000 or 7.6%, compared to the same periods in 2012.

The following tables show the major components of non-interest income:

	For the Three Months Ended September 30,			
	2013	2012	$ change	% change
Service charges on deposits	$ 318,064	$ 287,101	$ 30,963	10.8%
Earnings on cash surrender value of life insurance	100,660	105,000	(4,340)	(4.1)%
Mortgage commissions	59,944	63,792	(3,848)	(6.0)%
Gains on called securities	18,091	35,406	(17,315)	(48.9)%
Other income	368,807	299,150	69,657	23.3%
Total non-interest income	$ 865,566	$ 790,449	$ 75,117	9.5%

	For the Nine Months Ended September 30,			
	2013	2012	$ change	% change
Service charges on deposits	$ 903,599	$ 868,677	$ 34,922	4.0%
Earnings on cash surrender value of life insurance	306,207	315,000	(8,793)	(2.8)%
Mortgage commissions	196,646	171,579	25,067	14.6%
Gains on called securities	52,656	70,410	(17,754)	(25.2)%
Other income	1,008,802	868,169	140,633	16.2%
Total non-interest income	$ 2,467,910	$ 2,293,835	$ 174,075	7.6%

Service charges on deposits increased by $31,000 and $35,000 for the third quarter and nine month period ended September 30, 2013, respectively, compared to the same periods in 2012, as a result of an increase in the number of transaction deposit accounts. Mortgage commissions have decreased by $4,000 for the third quarter and increased by $25,000 for the nine month period of 2013, as compared to the same periods of 2012 as a result of the escalated demand for home purchases and refinancing due in part to the current low interest rate environment. The decrease in the third quarter reflects the recent retraction in mortgage activity as a result of the rise in long-term interest rates that occurred towards the end of the second quarter of 2013.

Other income increased by $70,000 and $141,000 for the three and nine month periods ended September 30, 2013, respectively, as compared to the same periods of 2012, mainly as a result of the year-to-date increases of $68,000 in investment service fee income, $83,000 in debit card fee income, and a decrease in the checking cash back rewards contra expense accrual of $93,000.

Non-Interest Expense

Non-interest expense represents salaries and benefits, occupancy expenses, professional expenses, outside services, and other miscellaneous expenses necessary to conduct business.

The following tables show the major components of non-interest expenses:

	For the Three Months Ended September 30,			
	2013	**2012**	**$ change**	**% change**
Salaries and employee benefits	$ 2,451,037	$ 2,462,468	$ (11,431)	(0.5)%
Occupancy	738,937	766,401	(27,464)	(3.6)%
Data processing fees	330,603	282,347	48,256	17.1%
OREO expenses	1,409	0	1,409	n/a
Regulatory assessments (FDIC & DFI)	120,000	114,000	6,000	5.3%
Other	976,444	901,973	74,471	8.3%
Total non-interest income	$ 4,618,430	$ 4,527,189	$ 91,241	2.0%

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	For the Nine Months Ended September 30,			
	2013	2012	$ change	% change
Salaries and employee benefits	$ 7,590,178	$ 7,552,214	$ 37,964	0.5%
Occupancy	2,220,320	2,260,483	(40,163)	(1.8)%
Data processing fees	938,206	838,211	99,995	11.9%
OREO expenses	2,193	18,358	(16,165)	(88.1)%
Regulatory assessments (FDIC & DFI)	360,000	347,000	13,000	3.7%
Other	2,880,486	2,719,706	160,780	5.9%
Total non-interest income	$ 13,991,383	$ 13,735,972	$ 255,411	1.9%

Non-interest expenses increased by $91,000 or 2.0% and 255,000 or 1.9% for the three and nine months ended September 30, 2013, respectively, as compared to the same periods of 2012. Salaries and employee benefits decreased $11,000 for the third quarter and increased $38,000 for the nine months ended September 30, 2013, as compared to the same periods of 2012. To support our emphasis on superior customer service, we increased our full-time equivalent staff by 9 as of September 30, 2013 compared to last year, which resulted in increased salary expense and group medical insurance benefits. The salary and benefit year-to-date increase was offset in part by an increase in deferred loan costs of $238,000, stemming from strong loan production during the first nine months of 2013. Data processing fees increased by $48,000 and $100,000 for the three and nine month periods ended September 30, 2013, respectively, from the comparable 2012 periods, as a result of an increased number of transaction accounts and the expansion of our products and services. Also contributing was an increase in other expense of $74,000 and $161,000 for the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012, due to a combination of expenses incurred to support the growth of our product lines and services.

FDIC and DFI (California Department of Financial Institutions) regulatory assessments were $120,000 and $360,000 for the three and nine months ended September 30, 2013, respectively, representing an increase of $6,000 and $13,000 compared to the same periods of 2012. The initial base assessment rate for financial institutions varies based on the overall risk profile of the institution as defined by the FDIC. The increase in 2013 is due to a higher deposit base in 2013 as compared to 2012, as the FDIC assessment rates are applied to average quarterly total liabilities as the primary basis.

Occupancy expenses decreased by $27,000 and $40,000 for the three and nine months ended September 30, 2013, respectively, as compared to the prior year.

OREO expenses were $1,000 and $2,000 for the three and nine months ended September 30, 2013, respectively, compared to no expense recorded in the third quarter of 2012 and expense of $18,000 for nine month period of 2012. Included within the year-to-date totals were gains from OREO sales of $17,000 in 2013 compared to gains of $4,000 in 2012. The remaining expense is attributed to general overhead such as property taxes and utilities associated with the properties classified as other real estate owned. There have been three foreclosures and two subsequent sales which has increased our OREO inventory from one property as of September 30, 2012 to three properties as of September 30, 2013. There were two sales of OREO properties during the first nine months of 2013 resulting in a gain on sale of $17,000, compared to one sale during the first nine months of 2012 that resulted in a gain of $4,000.

Management anticipates that noninterest expense will continue to increase as we continue to grow. However, management remains committed to cost-control and efficiency, and we expect to keep these increases to a minimum relative to growth.

Income Taxes

We reported a provision for income taxes of $672,000 and $1,901,000 for the three and nine month periods ended September 30, 2013, respectively, representing decreases of $66,000 and $195,000, as compared to the provisions reported in the comparable periods of 2012. The effective income tax rate on income from continuing operations was 30.9% and 31.3% for the three and nine months ended September 30, 2013, respectively, compared to 33.3% and 32.8% for the comparable periods of 2012. These provisions reflect accruals for taxes at the applicable rates for federal income tax and California franchise tax based upon reported pre-tax income, and adjusted for the effects of all permanent differences between income for tax and financial reporting purposes (such as earnings on qualified municipal securities, BOLI and certain tax-exempt loans). The disparity between the effective tax rates for 2013 as compared to 2012 is primarily due to tax credits from California Enterprise Zones and low income housing projects as well as tax free-income on loans within these enterprise zones and municipal securities and loans that comprise a larger proportion of pre-tax income in 2013 as compared to 2012.

Asset Quality

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

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

Non-accrual loans totaled $3.58 million at September 30, 2013, as compared to $6.92 million at December 31, 2012. The non-accrual loans as of September 30, 2013 are loans made to six borrowers primarily for purposes of commercial real estate. As of September 30, 2013, we had three loans considered troubled debt restructurings totaling $1.21 million, all of which are included in non-accrual loans.

OREO as of September 30, 2013 consisted of three properties, one of which was a residential land acquired through foreclosure that was written down to a zero balance because the public utilities have not been obtainable rendering these land lots unmarketable at this time. The other two OREO properties consisted of commercial real estate totaling $916,000 and were acquired through foreclosure.

The following table presents information about the Bank s non-performing assets, including asset quality ratios as of September 30, 2013 and December 31, 2012:

Non-Performing Assets

(in thousands)	**September 30, 2013**	**December 31, 2012**
Loans in non-accrual status	$ 3,579	$ 6,923
Loans past due 90 days or more and accruing	0	0
Total non-performing loans	3,579	6,923
Other real estate owned	916	0
Total non-performing assets	$ 4,495	$ 6,923
Allowance for loan losses	$ 7,669	$ 7,975
Asset quality ratios:		
Non-performing assets to total assets	0.68%	1.05%
Non-performing loans to total loans	0.86%	1.77%
Allowance for loan losses to total loans	1.85%	2.04%
Allowance for loan losses to total non-performing loans	214.33%	115.19%

Non-performing assets decreased by $2,428,000 as of September 30, 2013 as compared to December 31, 2012, primarily as a result of the $3,344,000 reduction in non-accrual loans. This reduction was due to principal payments of $1,758,000, loans foreclosed on and transferred to OREO of $1,881,000, charge-offs of $593,000 and three loans totaling $643,000 that were placed back on accrual status. These reductions were offset by additions of $1,744,000 for new loans placed on non-accrual status and an advance on an existing non-accrual loan of $138,000. Additionally, OREO balances increased by $916,000 during the nine month period ended September 30, 2013 due to foreclosures on four loans, two of which were subsequently sold during the period.

Allowance for Loan and Lease Losses (ALLL)

In anticipation of credit risk inherent in our lending business, we routinely set aside allowances through charges to earnings. Such charges are not only made for the outstanding loan portfolio, but also for off-balance sheet items, such as commitments to extend credits or letters of credit. Charges made for the outstanding loan portfolio have been credited to the allowance for loan losses, whereas charges for off-balance sheet items have been credited to the reserve for off-balance sheet items, which is presented as a component of other liabilities. The Company recorded loan loss provisions of $100,000 and $300,000 for the three and nine month periods in 2013, respectively, which decreased by $200,000 and $600,000, as compared to the provisions recorded in the same periods of 2012.

The allowance for loan losses decreased by $306,000 or 3.8%, to $7.67 million at September 30, 2013, as compared with $7.97 million at December 31, 2012. The Company recognized the decrease in the allowance for loan losses during the first nine months of the year due to the net loan charge-offs of $606,000 which was partially offset by loan loss provision of $300,000. The financial condition of certain Bank clients has stabilized which has improved the overall credit risk of the loan portfolio as evidenced by our decrease in non-accrual loans. The decrease to the allowance for loan losses resulted in a decrease in the allowance for loan losses as a percentage of total loans to 1.85% at September 30, 2013, as compared to 2.04% at December 31, 2012.

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

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The Company makes provisions for loan losses when required to bring the total allowance for loan and lease losses to a level deemed appropriate for the level of risk in the loan portfolio. At least quarterly, management conducts an assessment of the overall quality of the loan portfolio and general economic trends in the local market. The determination of the appropriate level for the allowance is based on that review, considering such factors as historical experience, the volume and type of lending conducted, the amount of and identified potential loss associated with specific non-performing loans, regulatory policies, general economic conditions, and other factors related to the collectability of loans in the portfolio.

Although management believes the allowance at September 30, 2013 was adequate to absorb probable losses from any known and inherent risks in the portfolio, no assurance can be given that the adverse effect of current and future economic conditions on our service areas, or other variables, will not result in increased losses in the loan portfolio in the future.

Investment Activities

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

Cash Equivalents and Interest-bearing Deposits in other Financial Institutions

The Company holds federal funds sold, unpledged available-for-sale securities and salable government guaranteed loans to help meet liquidity requirements and provide temporary holdings until the funds can be otherwise deployed or invested. As of September 30, 2013, and December 31, 2012, we had $99.8 million and $141.3 million, respectively, in cash and cash equivalents.

Investment Securities

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

Management has evaluated the investment securities portfolio to determine if the impairment of any security in an unrealized loss position is temporary or other than temporary. We conduct a periodic review and evaluation of the securities portfolio to determine if the value of any security has declined below its carrying value. If such decline is deemed other than temporary, we would adjust the carrying amount of the

security by writing down the security to fair value through a charge to current period income or a charge to accumulated other comprehensive income depending on the nature of the impairment and managements intent or requirement to sell the security. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due primarily to interest rate changes.

Deposits

Total deposits at September 30, 2013 were $591.6 million, a $4.6 million or 0.8% decrease from the deposit total of $587.0 million at December 31, 2012. Average deposits increased $50.8 million to $575.7 million for the nine month period ended September 30, 2013 as compared to the same period in 2012. We attracted deposits due to the safety and soundness of the Bank and our focus on customer service.

(in thousands)	September 30, 2013	December 31, 2012	Nine month change $	Nine month change %
Demand	$ 175,221	$ 175,588	$ (367)	(0.2)%
NOW	89,019	83,861	5,158	6.2%
MMDA	236,724	238,997	(2,273)	(1.0)%
Savings	37,432	30,181	7,251	24.0%
Time < $100K	19,505	20,421	(916)	(4.5)%
Time > $100K	33,741	37,945	(4,204)	(11.1)%
	$ **591,642**	$ **586,993**	$ **4,649**	**0.8%**

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Because our client base is comprised primarily of commercial and industrial accounts, individual account balances are generally higher than those of consumer-oriented banks. Seven of our clients carry deposit balances of more than 1% of our total deposits, two of which had a deposit balance of more than 3% of total deposits at September 30, 2013.

Since our deposit growth strategy emphasizes core deposit growth we have avoided relying on brokered deposits as a consistent source of funds. The Company had $1.9 and $2.0 million in brokered deposits as of September 30, 2013 and December 31, 2012, respectively. The only brokered deposits the Bank holds are from CDARS and ICS, a certificate of deposit and money market account program, respectively, that exchanges funds with other network banks to offer full FDIC insurance coverage to the customer.

Borrowings

Although deposits are the primary source of funds for our lending and investment activities and for general business purposes, we may obtain advances from the Federal Home Loan Bank of San Francisco (FHLB) as an alternative to retail deposit funds. Our outstanding FHLB advances were paid in full during the first quarter of 2012 and remained a zero balance at December 31, 2012 and September 30, 2013, due to elevated liquidity levels from increased deposits and loan payments that allowed us to pay the advances off. See Liquidity Management below for the details on the FHLB borrowings program.

Capital Ratios

The Company is regulated by the Board of Governors of the Federal Reserve Board (FRB) and is subject to the securities registration and public reporting regulations of the Securities and Exchange Commission. The primary federal regulator our banking subsidiary is the FRB. The banking subsidiary is also regulated by the Federal Deposit Insurance Corporation (FDIC) and the California Department of Financial Institutions (DFI). We are not aware of any recommendations of regulatory authorities or otherwise which, if they were to be implemented, would have a material effect on our liquidity, capital resources, or operations.

We must comply with regulatory capital requirements established by the FRB and FDIC. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. These capital standards require us to maintain minimum ratios of Tier 1 capital to total risk-weighted assets and total capital to risk-weighted assets of 4.00% and 8.00%, respectively. Tier 1 capital is comprised of total shareholders equity calculated in accordance with generally accepted accounting principles, excluding accumulated other comprehensive income (loss), less intangible assets, and total capital is comprised of Tier 1 capital plus certain adjustments, the largest of which is our allowance for loan losses. Risk-weighted assets refer to our on- and off-balance sheet exposures, adjusted for their related risk levels using formulas set forth in FRB and FDIC regulations.

In addition to the risk-based capital requirements described above, we are subject to a leverage capital requirement, which calls for a minimum ratio of Tier 1 capital (as defined above) to quarterly average total assets of 3.00% to 5.00%, depending upon the institution s composite ratings as determined by its regulators. The FRB has not advised us of any requirement specifically applicable to us.

Failure to meet minimum capital requirements can trigger regulatory actions that could have a material adverse effect on our financial statements and operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that rely on quantitative measures of our assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

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The following table shows our capital ratios, as calculated under regulatory guidelines, compared to the regulatory minimum capital ratios and the regulatory minimum capital ratios needed to qualify as a well-capitalized institution at September 30, 2013 and December 31, 2012:

Oak Valley Community Bank Capital Ratios

(dollars in thousands)

	Actual		Amount of Capital Required To Be Well-Capitalized		Amount of Capital Required To Be Adequately Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2013:						
Total Capital (to Risk-Weighted Assets)	$ 70,089	14.3%	$ 49,136	10%	$ 39,309	8%
Tier 1 Capital (to Risk-Weighted Assets)	$ 63,926	13.0%	$ 29,481	6%	$ 19,654	4%
Tier 1 Capital (to Average Assets)	$ 63,926	9.9%	$ 32,298	5%	$ 25,839	4%
As of December 31, 2012:						
Total Capital (to Risk-Weighted Assets)	$ 72,230	16.0%	$ 45,035	10%	$ 36,028	8%
Tier 1 Capital (to Risk-Weighted Assets)	$ 66,570	14.8%	$ 27,021	6%	$ 18,014	4%
Tier 1 Capital (to Average Assets)	$ 66,570	10.3%	$ 32,310	5%	$ 25,848	4%

Oak Valley Bancorp Capital Ratios

(dollars in thousands)

	Actual		Amount of Capital Required To Be Well-Capitalized		Amount of Capital Required To Be Adequately Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2013 , 2009:						
Total Capital (to Risk-Weighted Assets)	$ 70,348	14.3%	N/A	N/A	$ 39,314	8%
Tier 1 Capital (to Risk-Weighted Assets)	$ 64,185	13.1%	N/A	N/A	$ 19,657	4%
Tier 1 Capital (to Average Assets)	$ 64,185	9.9%	N/A	N/A	$ 25,841	4%
As of December 31, 2012:						
Total Capital (to Risk-Weighted Assets)	$ 72,376	16.1%	N/A	N/A	$ 36,030	8%
Tier 1 Capital (to Risk-Weighted Assets)	$ 66,716	14.8%	N/A	N/A	$ 18,015	4%
Tier 1 Capital (to Average Assets)	$ 66,716	10.3%	N/A	N/A	$ 25,850	4%

Our bank subsidiary is also subject to capital requirements similar to those discussed above. The bank subsidiary s capital ratios do not vary materially from our capital ratios presented above. At September 30, 2013, our bank subsidiary exceeded the minimum ratios established by the FRB and FDIC.

Liquidity Management

Since the Company is a holding company and does not conduct regular banking operations, its primary sources of liquidity are dividends from the Bank. Under the California Financial Code, payment of a dividend from the Bank to the Company is restricted to the lesser of the Bank s retained earnings or the amount of the Bank s undistributed net profits from the previous three fiscal years. The primary uses of funds for the Company are stockholder dividends, investment in the Bank and ordinary operating expenses. Management anticipates that there will be sufficient earnings at the Bank level to provide dividends to the Company to meet its funding requirements for the foreseeable future.

Maintenance of adequate liquidity requires that sufficient resources be available at all times to meet our cash flow requirements. Liquidity in a banking institution is required primarily to provide for deposit withdrawals and the credit needs of its customers and to take advantage of investment opportunities as they arise. Liquidity management involves our ability to convert assets into cash or cash equivalents without incurring significant loss, and to raise cash or maintain funds without incurring excessive additional cost. For this purpose, we maintain a portion of our funds in cash and cash equivalents, salable government guaranteed loans and securities available for sale. We obtain funds from the repayment and maturity of loans as well as deposit inflows, investment security maturities and paydowns, Federal funds purchased, FHLB advances, and other borrowings. Our primary uses of funds are the origination of loans, the purchase of investment securities, withdrawals of deposits, maturity of certificate of deposits, repayment of borrowings and dividends to common and preferred stockholders. Our liquid assets at September 30, 2013 were $172.2 million compared to $200.1 million at December 31, 2012. Our liquidity level measured as the percentage of liquid assets to total assets was 26.1% and 30.3% at September 30, 2013 and December 31, 2012, respectively. We anticipate that cash and cash equivalents on hand and other sources of funds will provide adequate liquidity for our operating, investing and financing needs and our regulatory liquidity requirements for the foreseeable future. Management monitors our liquidity position daily, balancing loan funding/payments with changes in deposit activity and overnight investments.

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As a secondary source of liquidity, we rely on advances from the FHLB to supplement our supply of lendable funds and to meet deposit withdrawal requirements. Advances from the FHLB are typically secured by a portion of our loan portfolio. The FHLB determines limitations on the amount of advances by assigning a percentage to each eligible loan category that will count towards the borrowing capacity. As of September 30, 2013, our borrowing capacity from the FHLB was approximately $161.0 million and there were no outstanding advances. We also maintain 2 lines of credit with correspondent banks to purchase up to $25 million in federal funds, for which there were no advances as of September 30, 2013.

Off-Balance-Sheet Arrangements

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

As of September 30, 2013 and December 31, 2012, we had commitments to extend credit of $55.0 million and $42.2 million, respectively, which includes obligations under letters of credit of $0.4 million and $0.5 million, respectively.

The effect on our revenues, expenses, cash flows and liquidity from the unused portion of the commitments to provide credit cannot be reasonably predicted because there is no guarantee that the lines of credit will be used.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 4. Controls and Procedures

The Company s Chief Executive Officer and its Chief Financial Officer, after evaluating the effectiveness of the Company s disclosure controls and procedures, as defined in Exchange Act Rules 13 a-15(e) and 15(d)-15(e) promulgated under the Exchange Act, as of the end of the period covered by this report (the Evaluation Date) have concluded that as of the Evaluation Date, the Company s disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company would be made known to them by others within the Company, particularly during the period in which this report was being prepared. Disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There were no significant changes in our internal control over financial reporting during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting subsequent to the Evaluation Date, nor were there any significant deficiencies or material weaknesses in such controls requiring corrective actions.

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PART II - OTHER INFORMATION

Item 1. **Legal Proceedings**

There are no pending, or to management s knowledge, any threatened, material legal proceedings to which we are a defendant, or to which any of our properties are subject. There are no material legal proceedings to which any director, any nominee for election as a director, any executive officer, or any associate of any such director, nominee or officer is a party adverse to us.

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

None.

Item 3. **Defaults Upon Senior Securities**

None.

Item 4. **Mine Safety Disclosures**

None.

Item 5. **Other Information**

None.

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Item 6. **Exhibits**

The following exhibits are filed as part of this report or hereby incorporated by reference to filings previously made with the SEC:

Exhibit No.	Exhibit Description
31.01	Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.02	Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.01	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

*In accordance with Rule 406T of Regulation S-T, the information in these exhibits is furnished and shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.

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SIGNATURES

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

Oak Valley Bancorp

Date: November 12, 2013 By: /s/ RICHARD A. MCCARTY

Richard A. McCarty
Executive Vice President and Chief Financial Officer
(Principal Financial Officer and duly authorized signatory)

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