UNITED SECURITY BANCSHARES
Form 10-Q
May 09, 2014
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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 MARCH 31, 2014 |
| o | TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM TO . |

Commission file number: 000-32897

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

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

Aggregate market value of the Common Stock held by non-affiliates as of the last business day of the registrant's most recently completed second fiscal quarter - June 30, 2013: $43,148,493

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

Common Stock, no par value
(Title of Class)

Shares outstanding as of April 30, 2014: 14,947,834

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PART I. Financial Information

United Security Bancshares and Subsidiaries
Consolidated Balance Sheets – (unaudited)
March 31, 2014 and December 31, 2013

| (in thousands except shares) | March 31, 2014 | December 31, 2013 |
|---|---|---|
| Assets | | |
| Cash and due from banks | $20,149 | $20,193 |
| Cash and due from Federal Reserve Bank | 116,458 | 115,019 |
| Cash and cash equivalents | 136,607 | 135,212 |
| Interest-bearing deposits in other banks | 1,516 | 1,515 |
| Investment securities available for sale (at fair value) | 52,741 | 43,616 |
| Loans and leases | 411,945 | 395,317 |
| Unearned fees and unamortized loan origination costs | (522) | (304) |
| Allowance for credit losses | (11,084) | (10,988) |
| Net loans and leases | 400,339 | 384,025 |
| Accrued interest receivable | 1,591 | 1,644 |
| Premises and equipment – net | 12,007 | 12,122 |
| Other real estate owned | 14,462 | 13,946 |
| Intangible assets | 16 | 62 |
| Goodwill | 4,488 | 4,488 |
| Cash surrender value of life insurance | 17,330 | 17,203 |
| Investment in limited partnerships | 4,531 | 4,534 |
| Deferred income taxes - net | 11,786 | 11,630 |
| Other assets | 5,495 | 5,932 |
| Total assets | $662,909 | $635,929 |
| | | |
| Liabilities & Shareholders' Equity | | |
| Liabilities | | |
| Deposits | | |
| Noninterest bearing | $236,502 | $214,317 |
| Interest bearing | 331,780 | 328,172 |
| Total deposits | 568,282 | 542,489 |
| | | |
| Accrued interest payable | 42 | 44 |
| Accounts payable and other liabilities | 5,613 | 5,728 |
| Junior subordinated debentures (at fair value) | 11,532 | 11,125 |
| Total liabilities | 585,469 | 559,386 |
| | | |
| Shareholders' Equity | | |
| Common stock, no par value 20,000,000 shares authorized,14,947,834 issued and outstanding at March 31, 2014, and 14,799,888 at December 31, 2013 | 46,640 | 45,778 |
| Retained earnings | 30,939 | 30,884 |
| Accumulated other comprehensive loss | (139) | (119) |
| Total shareholders' equity | 77,440 | 76,543 |
| Total liabilities and shareholders' equity | $662,909 | $635,929 |

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

| | Three Months Ended March 31, | |
|---|---|---|
| (In thousands except shares and EPS) | 2014 | 2013 |
| Interest Income: | | |
| Loans, including fees | $5,475 | $5,466 |
| Investment securities – AFS – taxable | 228 | 198 |
| Interest on deposits in FRB | 83 | 65 |
| Interest on deposits in other banks | 2 | 2 |
| Total interest income | 5,788 | 5,731 |
| Interest Expense: | | |
| Interest on deposits | 262 | 411 |
| Interest on other borrowings | 61 | 60 |
| Total interest expense | 323 | 471 |
| Net Interest Income Before Provision for Credit Losses | 5,465 | 5,260 |
| Recovery of Provision for Credit Losses | (47) | (9) |
| Net Interest Income | 5,512 | 5,269 |
| Noninterest Income: | | |
| Customer service fees | 794 | 779 |
| Increase in cash surrender value of bank-owned life insurance | 127 | 137 |
| Loss on fair value of financial liability | (345) | (557) |
| Other | 141 | 160 |
| Total noninterest income | 717 | 519 |
| Noninterest Expense: | | |
| Salaries and employee benefits | 2,526 | 2,361 |
| Occupancy expense | 873 | 905 |
| Data processing | 41 | 60 |
| Professional fees | 180 | 445 |
| Regulatory assessments | 233 | 359 |
| Director fees | 56 | 58 |
| Amortization of intangibles | 47 | 47 |
| Correspondent bank service charges | 29 | 76 |
| Loss on California tax credit partnership | 23 | 33 |
| Net cost (gain) on operation and sale of OREO | 281 | (882) |
| Other | 506 | 611 |
| Total noninterest expense | 4,795 | 4,073 |
| Income Before Provision for Taxes | 1,434 | 1,715 |
| Provision for Taxes on Income | 526 | 640 |
| Net Income | $908 | $1,075 |
| | | |
| Net Income per common share | | |
| Basic | $0.06 | $0.07 |
| Diluted | $0.06 | $0.07 |
| Shares on which net income per common shares were based | | |
| Basic | 14,947,834 | 14,942,421 |
| Diluted | 14,954,938 | 14,944,408 |

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

| | Three Months Ended March 31, 2014 | Three Months Ended March 31, 2013 |
|---|---|---|
| Net Income | $908 | $1,075 |
| | | |
| Unrealized holdings gains (losses) on securities | (49) | (110) |
| Unrealized gains on unrecognized post retirement costs | 16 | 19 |
| Other comprehensive loss, before tax | (33) | (91) |
| Tax benefit related to securities | 19 | 44 |
| Tax expense related to unrecognized post retirement costs | (6) | (8) |
| Total other comprehensive loss | (20) | (55) |
| Comprehensive income | $888 | $1,020 |

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

| (In thousands except shares) | Common stock Number of Shares | Amount | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total |
|---|---|---|---|---|---|
| Balance December 31, 2012 | 14,217,303 | $43,173 | $26,179 | $ 89 | $69,441 |
| Other comprehensive loss | | | | (55) | (55) |
| Common stock dividends | 142,157 | 619 | (619) | | 0 |
| Stock-based compensation expense | | 4 | | | 4 |
| Net Income | | | 1,075 | | 1,075 |
| Balance March 31, 2013 | 14,359,460 | $43,796 | $26,635 | $ 34 | $70,465 |
| Other comprehensive loss | | | | (153) | (153) |
| Common stock dividends | 435,226 | 1,945 | (1,945) | | |
| Common stock issuance | 5,202 | 12 | | | 12 |
| Stock-based compensation expense | | 25 | | | 25 |
| Net Income | | | 6,194 | | 6,194 |
| Balance December 31, 2013 | 14,799,888 | $45,778 | $30,884 | $ (119) | $76,543 |
| Other comprehensive loss | | | | (20) | (20) |
| Common stock dividends | 147,946 | 853 | (853) | | 0 |
| Stock options exercised | — | — | | | — |
| Stock-based compensation expense | | 9 | | | 9 |
| Net Income | | | 908 | | 908 |
| Balance March 31, 2014 | 14,947,834 | $46,640 | $30,939 | $ (139) | $77,440 |

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

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| (In thousands) | Three Months Ended March 31, 2014 | 2013 |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Net Income | $908 | $1,075 |
| Adjustments to reconcile net income:to cash provided by operating activities: | | |
| Benefit for credit losses | (47) | (9) |
| Depreciation and amortization | 329 | 226 |
| Amortization of investment securities | 47 | 8 |
| Accretion of investment securities | (9) | (18) |
| Decrease in accrued interest receivable | 53 | 89 |
| Decrease in accrued interest payable | 2 | 6 |
| Decrease in accounts payable and accrued liabilities | (35) | (431) |
| Increase (decrease) in unearned fees | 218 | (37) |
| Increase (decrease) in income taxes payable | 666 | (837) |
| Stock-based compensation expense | 9 | 4 |
| (Benefits) provision for deferred income taxes | (142) | 229 |
| Gain on sale of other real estate owned | — | (1,025) |
| Impairment loss on other real estate owned | — | 118 |
| Increase in surrender value of life insurance | (127) | (128) |
| Loss on fair value option of financial liabilities | 345 | 557 |
| Loss on tax credit limited partnership interest | 23 | 33 |
| Amortization of CDI | 47 | 47 |
| Net decrease in other assets | (186) | (11) |
| Net cash provided by (used in) operating activities | 2,101 | (104) |
| | | |
| Cash Flows From Investing Activities: | | |
| Net increase in interest-bearing deposits with banks | (1) | (2) |
| Redemption of correspondent bank stock | — | 242 |
| Purchases of available-for-sale securities | (10,192) | — |
| Maturities and calls of available-for-sale securities | — | 3,855 |
| Principal payments of available-for-sale securities | 980 | — |
| Net (increase) decrease in loans | (17,001) | 931 |
| Cash proceeds from sales of other real estate owned | — | 3,318 |
| Investment in limited partnership | (70) | — |
| Capital expenditures (sales) of premises and equipment | (215) | 51 |
| Net cash (used in) provided by investing activities | (26,499) | 8,395 |
| | | |
| Cash Flows From Financing Activities: | | |
| Net increase (decrease) in demand deposits and savings accounts | 23,923 | (10,600) |
| Net increase (decrease) in certificates of deposit | 1,870 | (2,868) |
| Net cash provided by (used in) financing activities | 25,793 | (13,468) |
| | | |
| Net increase (decrease) in cash and cash equivalents | 1,395 | (5,177) |
| Cash and cash equivalents at beginning of period | 135,212 | 141,627 |
| Cash and cash equivalents at end of period | $136,607 | $136,450 |

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

1. Organization and Summary of Significant Accounting and Reporting Policies

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

These unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information on a basis consistent with the accounting policies reflected in the audited financial statements of the Company included in its 2013 Annual Report on Form 10-K. These interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of a normal, recurring nature) considered necessary for a fair presentation have been included. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for any other interim period or for the year as a whole.

Recently Issued Accounting Standards:

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

In November 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-04 Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. The amendments in the ASU clarify when an in substance repossession or foreclosure occurs - that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The new ASU requires a creditor to reclassify a collateralized consumer mortgage loan to real estate property upon obtaining legal title to the real estate collateral, or the borrower voluntarily conveying all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. The ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15 2014.

In February 2013, The Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, to improve the transparency of reporting reclassifications out of accumulated other comprehensive income. ASU 2013-02 requires an organization to present (either on the face of the statement where net income is presented or in the notes) the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income–but only if the item reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. The amendments are effective for reporting periods beginning after December 15, 2012.  The amounts reclassified out of net income were not significant and this ASU did not have a significant impact on the Company’s financial statements.

In January 2013, the FASB issued ASU No. 2013-01 Balance Sheet (Topic 210) Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities, which clarifies that ordinary trade receivables and receivables are not in the scope of ASU 2011-11. It further clarifies that the scope of ASU No. 2011-11 applies to derivatives, repurchase agreements and reverse purchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with specific criteria contained in FASB Accounting Standards Codification® or subject to a master netting arrangement or similar agreement. Both ASU 2011-11 and ASU 2013-1 are effective for annual periods beginning on or after January 1, 2013, and interim periods within those annual periods. The Company adopted these ASUs during the first quarter of 2013 and they did not have a material impact on its financial statements.

In December 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-11 Balance Sheet (Topic 210) Disclosures about Offsetting Assets and Liabilities. The ASU enhances disclosures in order to improve the comparability of offsetting (netting) assets and liabilities reported in accordance with U.S. generally accepted

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accounting principles (GAAP) and International Financial Reporting Standards (IFRS) by requiring entities to disclose both gross information and net information about both instruments and transactions eligible for offset in the statements of condition and instruments and transactions subject to an agreement similar to a master netting arrangement. This ASU did not have a significant impact on the Company’s financial statements.

2. Investment Securities

Following is a comparison of the amortized cost and fair value of securities available-for-sale, as of March 31, 2014 and December 31, 2013:

| (In thousands)<br>March 31, 2014<br>Securities available for sale: | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value (Carrying Amount) |
|---|---|---|---|---|
| U.S. Government agencies | $13,677 | $422 | $— | $14,099 |
| U.S. Government collateralized mortgage obligations | 34,586 | 403 | (106) | 34,883 |
| Mutual Funds | 4,000 | — | (241) | 3,759 |
| Total securities available for sale | $52,263 | $825 | $(347) | $52,741 |
| December 31, 2013<br>Securities available for sale: | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value (Carrying Amount) |
| U.S. Government agencies | $14,060 | $441 | $— | $14,501 |
| U.S. Government collateralized mortgage obligations | 25,029 | 434 | (78) | 25,385 |
| Mutual Funds | 4,000 | — | (270) | 3,730 |
| Total securities available for sale | $43,089 | $875 | $(348) | $43,616 |

The amortized cost and fair value of securities available for sale at March 31, 2014, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties. Contractual maturities on collateralized mortgage obligations cannot be anticipated due to allowed paydowns. Mutual funds are included in the "due in one year or less" category below.

| | March 31, 2014 | |
|---|---|---|
| (In thousands) | Amortized Cost | Fair Value (Carrying Amount) |
| Due in one year or less | $4,000 | $3,759 |
| Due after one year through five years | 58 | 62 |
| Due after five years through ten years | — | — |
| Due after ten years | 13,619 | 14,037 |
| Collateralized mortgage obligations | 34,586 | 34,883 |
| | $52,263 | $52,741 |

There were no realized gains or losses on sale of available-for-sale securities for the three month periods ended March 31, 2014 and March 31, 2013. There were no other-than-temporary impairment losses for the three month periods ended March 31, 2014 and March 31, 2013.

At March 31, 2014 available-for-sale securities with an amortized cost of approximately $23,180,000 (fair value of $23,967,000) were pledged as collateral for FHLB borrowings and public funds balances.

The Company had no held-to-maturity or trading securities at March 31, 2014 or December 31, 2013.

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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.

The following summarizes temporarily impaired investment securities:

| (In thousands) | Less than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|---|
| March 31, 2014 Securities available for sale: | Fair Value (Carrying Amount) | Unrealized Losses | Fair Value (Carrying Amount) | Unrealized Losses | Fair Value (Carrying Amount) | Unrealized Losses |
| U.S. Government agencies | $— | $— | $— | $— | $— | $— |
| U.S. Government agency collateral mortgage obligations | 16,037 | (106) | — | — | 16,037 | (106) |
| Mutual Funds | — | — | 3,759 | (241) | 3,759 | (241) |
| Total impaired securities | $16,037 | $(106) | $3,759 | $(241) | $19,796 | $(347) |
| December 31, 2013 Securities available for sale: | | | | | | |
| U.S. Government agencies | $— | $— | $— | $— | $— | $— |
| U.S. Government agency collateral mortgage obligations | 11,069 | (78) | — | — | 11,069 | (78) |
| Mutual Funds | — | — | 3,730 | (270) | 3,730 | (270) |
| Total impaired securities | $11,069 | $(78) | $3,730 | $(270) | $14,799 | $(348) |

Temporarily impaired securities at March 31, 2014, were comprised of seven U.S. Government sponsored entities & agencies collateralized by mortgage obligations and one mutual fund.

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

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

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

Other-than-temporary-impairment occurs when the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-

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period credit loss, the other-than-temporary-impairment shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the other-than-temporary-impairment shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total other-than-temporary-impairment related to the credit loss is recognized in earnings, and is determined based on the difference between the present value of cash flows expected to be collected and the current amortized cost of the security. The amount of the total other-than-temporary-impairment related to other factors shall be recognized in other comprehensive (loss) income, net of applicable taxes. The previous amortized cost basis less the other-than-temporary-impairment recognized in earnings shall become the new amortized cost basis of the investment.

At March 31, 2014, the decline in market value of the impaired securities is attributable to changes in interest rates, and not credit quality. Because the Company does not have the intent to sell these impaired securities and it is not more likely than not that it will be required to sell the securities before their anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired at March 31, 2014.

3. Loans and Leases

Loans are comprised of the following:

| (In thousands) | March 31, 2014 | December 31, 2013 |
|---|---|---|
| Commercial and business loans | $63,896 | $68,460 |
| Government program loans | 1,896 | 2,226 |
| Total commercial and industrial | 65,792 | 70,686 |
| Real estate – mortgage: | | |
| Commercial real estate | 160,164 | 143,919 |
| Residential mortgages | 49,167 | 52,036 |
| Home Improvement and Home Equity loans | 1,336 | 1,410 |
| Total real estate mortgage | 210,667 | 197,365 |
| RE construction and development | 101,967 | 87,004 |
| Agricultural | 24,337 | 30,932 |
| Installment | 9,182 | 9,330 |
| Total Loans | $411,945 | $395,317 |

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

Commercial and industrial loans represent 16.0% of total loans at March 31, 2014 and are generally made to support the ongoing operations of small-to-medium sized commercial businesses. Commercial and industrial loans have a high degree of industry diversification and provide working capital, financing for the purchase of manufacturing plants and equipment, or funding for growth and general expansion of businesses. A substantial portion of commercial and industrial loans are secured by accounts receivable, inventory, leases, or other collateral including real estate. The remainder are unsecured; however, extensions of credit are predicated upon the financial capacity of the borrower. Repayment of commercial loans is generally from the cash flow of the borrower.

Real estate mortgage loans, representing 51.1% of total loans at March 31, 2014, are secured by trust deeds on primarily commercial property, but are also secured by trust deeds on single family residences. Repayment of real estate mortgage loans generally comes from the cash flow of the borrower.

- Commercial real estate mortgage loans comprise the largest segment of this loan category and are available on all types of income producing and commercial properties, including: office buildings, shopping centers; apartments and motels; owner occupied buildings; manufacturing facilities and more. Commercial real estate mortgage loans can also be used to refinance existing debt. Although real estate associated with the business is the primary collateral for commercial real estate mortgage loans, the underlying real estate is not the source of repayment.

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Commercial real estate loans are made under the premise that the loan will be repaid from the borrower's business operations, rental income associated with the real property, or personal assets.

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

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

Real estate construction and development loans, representing 24.8% of total loans at March 31, 2014, consist of loans for residential and commercial construction projects, as well as land acquisition and development, or land held for future development. Loans in this category are secured by real estate including improved and unimproved land, as well as single-family residential, multi-family residential, and commercial properties in various stages of completion. All real estate loans have established equity requirements. Repayment on construction loans generally comes from long-term mortgages with other lending institutions obtained at completion of the project.

Agricultural loans represent 5.9% of total loans at March 31, 2014 and are generally secured by land, equipment, inventory and receivables. Repayment is from the cash flow of the borrower.

Installment loans represent 2.2% of total loans at March 31, 2014 and generally consist of loans to individuals for household, family and other personal expenditures such as credit cards, automobiles or other consumer items.

In the normal course of business, the Company is party to financial instruments with off-balance sheet risk to meet the financing needs of its customers. At March 31, 2014 and December 31, 2013, these financial instruments include commitments to extend credit of $81,555,000 and $63,271,000, respectively, and standby letters of credit of $1,637,000 and $2,001,000, respectively. These instruments involve elements of credit risk in excess of the amount recognized on the balance sheet. The contract amounts of these instruments reflect the extent of the involvement the Company has in off-balance sheet financial instruments.

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

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

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

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Past Due Loans

The Company monitors delinquency and potential problem loans on an ongoing basis through weekly reports to the Loan Committee and monthly reports to the Board of Directors. The following is a summary of delinquent loans at March 31, 2014 (in thousands):

| March 31, 2014 | Loans 30-60 Days Past Due | Loans 61-89 Days Past Due | Loans 90 or More Days Past Due | Total Past Due Loans | Current Loans | Total Loans | Accruing Loans 90 or More Days Past Due |
|---|---|---|---|---|---|---|---|
| Commercial and Business Loans | $590 | $260 | $144 | $994 | $62,902 | $63,896 | $— |
| Government Program Loans | — | — | — | — | 1,896 | 1,896 | — |
| Total Commercial and Industrial | 590 | 260 | 144 | 994 | 64,798 | 65,792 | — |
| Commercial Real Estate Loans | 859 | — | 6,077 | 6,936 | 153,228 | 160,164 | — |
| Residential Mortgages | 250 | — | 343 | 593 | 48,574 | 49,167 | — |
| Home Improvement and Home Equity Loans | — | — | — | — | 1,336 | 1,336 | — |
| Total Real Estate Mortgage | 1,109 | — | 6,420 | 7,529 | 203,138 | 210,667 | — |
| RE Construction and Development Loans | — | — | 247 | 247 | 101,720 | 101,967 | — |
| Agricultural Loans | — | — | — | — | 24,337 | 24,337 | — |
| Consumer Loans | 34 | — | — | 34 | 8,891 | 8,925 | — |
| Overdraft protection Lines | — | — | — | — | 88 | 88 | — |
| Overdrafts | — | — | — | — | 169 | 169 | — |
| Total Installment/other | 34 | — | — | 34 | 9,148 | 9,182 | — |
| Total Loans | $1,733 | $260 | $6,811 | $8,804 | $403,141 | $411,945 | $— |

The following is a summary of delinquent loans at December 31, 2013 (in thousands):

| December 31, 2013 | Loans 30-60 Days Past Due | Loans 61-89 Days Past Due | Loans 90 or More Days Past Due | Total Past Due Loans | Current Loans | Total Loans | Accruing Loans 90 or More Days Past Due |
|---|---|---|---|---|---|---|---|
| Commercial and Business Loans | $— | $94 | $— | $94 | $68,366 | $68,460 | $— |
| Government Program Loans | — | — | — | — | 2,226 | 2,226 | — |
| | — | 94 | — | 94 | 70,592 | 70,686 | — |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Total Commercial and Industrial | | | | | | | |
| Commercial Real Estate Loans | 1,991 | — | 6,866 | 8,857 | 135,062 | 143,919 | — |
| Residential Mortgages | — | 614 | 359 | 973 | 51,063 | 52,036 | — |
| Home Improvement and Home Equity Loans | 96 | — | — | 96 | 1,314 | 1,410 | — |
| Total Real Estate Mortgage | 2,087 | 614 | 7,225 | 9,926 | 187,439 | 197,365 | — |
| RE Construction and Development Loans | — | — | 220 | 220 | 86,784 | 87,004 | — |
| Agricultural Loans | — | — | — | — | 30,932 | 30,932 | — |
| Consumer Loans | — | — | — | — | 9,086 | 9,086 | — |
| Overdraft protection Lines | — | — | — | — | 87 | 87 | — |
| Overdrafts | — | — | — | — | 157 | 157 | — |
| Total Installment | — | — | — | — | 9,330 | 9,330 | — |
| Total Loans | $2,087 | $708 | $7,445 | $10,240 | $385,077 | $395,317 | $— |

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Nonaccrual Loans

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

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

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

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

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

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

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

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

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

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

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

Nonaccrual loans totaled $10,507,000 and $12,341,000 at March 31, 2014 and December 31, 2013, respectively. There were no remaining undisbursed commitments to extend credit on nonaccrual loans at March 31, 2014 or December 31, 2013.

The following is a summary of nonaccrual loan balances at March 31, 2014 and December 31, 2013.

| | March 31, 2014 | December 31, 2013 |
|---|---|---|
| Commercial and Business Loans | $144 | |