Bank of Marin Bancorp
Form 10-Q
August 08, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

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

For the quarterly period ended June 30, 2011

OR

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 001-33572

Bank of Marin Bancorp
(Exact name of Registrant as specified in its charter)

California	20-8859754
(State or other jurisdiction of incorporation)	(IRS Employer Identification No.)
504 Redwood Blvd., Suite 100, Novato, CA	94947
(Address of principal executive office)	(Zip Code)

Registrant's telephone number, including area code: (415) 763-4520

Indicate by check mark whether the registrant (1) has filed all reports to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b(2) of the Exchange Act.

Large accelerated filer o   Accelerated filer x   Non-accelerated filer o   Smaller reporting company o

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

As of July 29, 2011 there were 5,326,686 shares of common stock outstanding.

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PART I FINANCIAL INFORMATION

ITEM 1. Financial Statements

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BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CONDITION
at June 30, 2011 and December 31, 2010

(in thousands, except share data; 2011 unaudited)	June 30, 2011	December 31, 2010
Assets		
Cash and due from banks	$88,043	$ 65,724
Short-term investments	22,116	19,508
Cash and cash equivalents	110,159	85,232
Investment securities		
Held to maturity, at amortized cost	35,514	34,917
Available for sale (at fair market value, amortized cost $164,731and $109,070 at June 30, 2011 and December 31, 2010,respectively)	167,406	111,736
Total investment securities	202,920	146,653
Loans, net of allowance for loan losses of $13,920 and $12,392at June 30, 2011 and December 31, 2010, respectively	972,714	929,008
Bank premises and equipment, net	9,280	8,419
Interest receivable and other assets	42,320	38,838
Total assets	$1,337,393	$ 1,208,150
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Non-interest bearing	$346,317	$ 282,195
Interest bearing		
Transaction accounts	133,429	105,177
Savings accounts	72,458	56,760
Money market accounts	403,782	371,352
CDARS® time accounts	31,674	67,261
Other time accounts	151,246	132,994
Total deposits	1,138,906	1,015,739
Federal Home Loan Bank borrowings	55,000	55,000
Subordinated debenture	5,000	5,000
Interest payable and other liabilities	9,429	10,491
Total liabilities	1,208,335	1,086,230
Stockholders' Equity		
Preferred stock, no par value, $1,000 per share liquidation preference		
Authorized - 5,000,000 shares; none issued	---	---
Common stock, no par value		

Authorized - 15,000,000 shares		
Issued and outstanding - 5,321,227 and 5,290,082 at June 30, 2011 and December 31, 2010, respectively	56,265	55,383
Retained earnings	71,241	64,991
Accumulated other comprehensive income, net	1,552	1,546
Total stockholders' equity	129,058	121,920
Total liabilities and stockholders' equity	$1,337,393	$ 1,208,150

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

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BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts; unaudited)	Three months ended June 30, 2011	March 31, 2011	June 30, 2010	Six months ended June 30, 2011	June 30, 2010
Interest income					
Interest and fees on loans	$16,862	$15,900	$14,169	$32,762	$27,850
Interest on investment securities					
Securities of U.S. Government agencies	745	733	885	1,478	1,613
Obligations of state and political subdivisions	303	302	285	605	571
Corporate debt securities and other	171	111	138	282	308
Interest on Federal funds sold and short-term investments	56	40	28	96	50
Total interest income	18,137	17,086	15,505	35,223	30,392
Interest expense					
Interest on interest bearing transaction accounts	48	38	26	86	49
Interest on savings accounts	25	29	27	54	52
Interest on money market accounts	341	337	729	678	1,526
Interest on CDARS® time accounts	48	94	233	142	442
Interest on other time accounts	315	358	377	673	731
Interest on borrowed funds	357	352	356	709	707
Total interest expense	1,134	1,208	1,748	2,342	3,507
Net interest income	17,003	15,878	13,757	32,881	26,885
Provision for loan losses	3,000	1,050	1,350	4,050	2,900
Net interest income after provision for loan losses	14,003	14,828	12,407	28,831	23,985
Non-interest income					
Service charges on deposit accounts	468	443	463	911	909
Wealth Management and Trust Services	469	434	368	903	763
Other income	644	722	674	1,366	1,182
Total non-interest income	1,581	1,599	1,505	3,180	2,854
Non-interest expense					
Salaries and related benefits	5,220	4,929	4,561	10,149	9,167
Occupancy and equipment	1,093	907	914	2,000	1,812
Depreciation and amortization	314	308	360	622	698
Federal Deposit Insurance Corporation insurance	214	387	375	601	737
Data processing	909	582	485	1,491	931
Professional services	740	733	454	1,473	886
Other expense	1,508	1,284	1,442	2,792	2,582
Total non-interest expense	9,998	9,130	8,591	19,128	16,813
Income before provision for income taxes	5,586	7,297	5,321	12,883	10,026

Provision for income taxes	2,147	2,788	1,983	4,935	3,741
Net income	$3,439	$4,509	$3,338	$7,948	$6,285
Net income per common share:					
Basic	$0.65	$0.85	$0.64	$1.50	$1.20
Diluted	$0.64	$0.84	$0.63	$1.48	$1.19
Weighted average shares used to compute net income per common share:					
Basic	5,300	5,283	5,234	5,292	5,226
Diluted	5,385	5,366	5,308	5,376	5,302
Dividends declared per common share	$0.16	$0.16	$0.15	$0.32	$0.30

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

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BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
for the year ended December 31, 2010 and the six months ended June 30, 2011

(dollars in thousands; 2011 unaudited)	Preferred Stock	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income, Net of Taxes	Total
Balance at December 31, 2009	---	5,229,529	$53,789	$54,644	$ 618	$109,051
Comprehensive income:						
Net income	---	---	---	13,552	---	13,552
Other comprehensive income						
Net change in unrealized gain on available for sale securities (net of tax effect of $672)	---	---	---	---	928	928
Comprehensive income	---	---	---	13,552	928	14,480
Stock options exercised	---	49,940	895	---	---	895
Excess tax benefit - stock-based compensation	---	---	132	---	---	132
Stock issued under employee stock purchase plan	---	563	17	---	---	17
Restricted stock granted	---	6,150	---	---	---	---
Restricted stock forfeited / cancelled	---	(2,320)	---	---	---	---
Stock-based compensation - stock options	---	---	241	---	---	241
Stock-based compensation - restricted stock	---	---	109	---	---	109
Cash dividends paid on common stock	---	---	---	(3,205)	---	(3,205)
Stock issued in payment of director fees	---	6,220	200	---	---	200
Balance at December 31, 2010	---	5,290,082	$55,383	$64,991	$ 1,546	$121,920
Comprehensive income:						
Net income	---	---	---	7,948	---	7,948
Other comprehensive income						
Net change in unrealized gain on available for sale securities (net of tax effect of $4)	---	---	---	---	6	6
Comprehensive income	---	---	---	7,948	6	7,954
Stock options exercised	---	22,168	472	---	---	472
Excess tax benefit - stock-based compensation	---	---	89	---	---	89
Stock issued under employee stock purchase plan	---	502	17	---	---	17
Restricted stock granted	---	5,675	---	---	---	---
Stock-based compensation - stock options	---	---	135	---	---	135

Stock-based compensation - restricted stock	---	---	69	---	---	69
Cash dividends paid on common stock	---	---	---	(1,698)	---	(1,698)
Stock issued in payment of director fees	---	2,800	100	---	---	100
Balance at June 30, 2011	---	5,321,227	$56,265	$71,241	$ 1,552	$129,058

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

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BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
for the six months ended June 30, 2011 and 2010

(in thousands, unaudited)	June 30, 2011	June 30, 2010
Cash Flows from Operating Activities:		
Net income	$7,948	$6,285
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	4,050	2,900
Compensation expense--common stock for director fees	110	100
Stock-based compensation expense	204	219
Excess tax benefits from exercised stock options	(73)	(63)
Amortization of investment security premiums, net of accretion of discounts	776	563
Accretion of discount on acquired loans	(2,211)	---
Depreciation and amortization	622	698
Bargain purchase gain on acquisition, net of tax	(85)	---
Loss on sale of repossessed assets	36	5
Net change in operating assets and liabilities:		
Interest receivable	(196)	140
Interest payable	25	100
Deferred rent and other rent-related expenses	162	124
Other assets	1,362	(318)
Other liabilities	(1,668)	528
Total adjustments	3,114	4,996
Net cash provided by operating activities	11,062	11,281
Proceeds from sale of furniture and equipment	18	---
Purchase of securities held-to-maturity	(700)	---
Purchase of securities available-for-sale	(76,537)	(27,390)
Proceeds from paydowns/maturity of securities available-for-sale	20,203	15,647
Loans originated and principal collected, net	16,156	(22,270)
Purchase of bank owned life insurance policies	(2,500)	---
Purchase of premises and equipment	(1,466)	(702)
Proceeds from sale of repossessed assets	199	114
Cash receipt from acquisition	44,042	---
Net cash used in investing activities	(585)	(34,601)
Cash Flows from Financing Activities:		
Net increase in deposits	29,086	55,117
Proceeds from stock options exercised	472	226
Repayment of Federal Home Loan Bank borrowings	(13,500)	---
Cash dividends paid on common stock	(1,698)	(1,572)
Stock issued under employee stock purchase plan	17	9
Excess tax benefits from exercised stock options	73	63
Net cash provided by financing activities	14,450	53,843
Net increase in cash and cash equivalents	24,927	30,523
Cash and cash equivalents at beginning of period	85,232	38,660
Cash and cash equivalents at end of period	$110,159	$69,183
Supplemental disclosure of non-cash investing and financing activities:		

Loans transferred to repossessed assets	100	$135
Stock issued in payment of director fees	$100	$100
Acquisition:		
Fair value of assets acquired	$107,763	---
Fair value of liabilities assumed	$107,678	---

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Introductory Explanation

References in this report to “Bancorp” mean the Bank of Marin Bancorp as the parent holding company for Bank of Marin, the wholly-owned subsidiary (the “Bank”). References to “we,” “our,” “us” mean the holding company and the Bank that are consolidated for financial reporting purposes.

Note 1: Basis of Presentation

The consolidated financial statements include the accounts of Bancorp and its only wholly-owned bank subsidiary, the Bank. All material intercompany transactions have been eliminated. In the opinion of Management, the unaudited interim consolidated financial statements contain all adjustments necessary to present fairly our financial position, results of operations, changes in stockholders' equity and cash flows. All adjustments are of a normal, recurring nature. Management has evaluated subsequent events through the date of filing, and has determined that there are no subsequent events that require recognition or disclosure.

Certain information and footnote disclosures presented in the annual consolidated financial statements are not included in the interim consolidated financial statements. Accordingly, the accompanying unaudited interim consolidated financial statements should be read in conjunction with our 2010 Annual Report on Form 10-K. The results of operations for the three months and six months ended June 30, 2011 are not necessarily indicative of the operating results for the full year.

The following table shows: 1) weighted average basic shares, 2) potential common shares related to stock options, non-vested restricted stock and stock warrant, and 3) weighted average diluted shares. Basic earnings per share (“EPS”) are calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during each period. Diluted EPS are calculated using the weighted average diluted shares. The number of potential common shares included in quarterly diluted EPS is computed using the average market prices during the three months included in the reporting period. Our calculation of weighted average shares includes two forms of our 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.

	Three months ended			Six months ended	
(in thousands, except per share data; unaudited)	June 30, 2011	March 31, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Weighted average basic shares outstanding	5,300	5,283	5,234	5,292	5,226
Add: Potential common shares related to stock options	43	42	45	43	47
Potential common shares related to non-vested restricted stock	3	5	3	4	4
Potential common shares related to warrant	39	36	26	37	25
Weighted average diluted shares outstanding	5,385	5,366	5,308	5,376	5,302
Net income available to common stockholders	$ 3,439	$ 4,509	$ 3,338	$ 7,948	$ 6,285

Basic EPS	$	0.65	$	0.85	$	0.64	$	1.50	$	1.20
Diluted EPS	$	0.64	$	0.84	$	0.63	$	1.48	$	1.19
Weighted average anti-dilutive shares not included in the calculation of diluted EPS Stock options		73		64		170		66		163
Non-vested restricted stock		6		---		---		3		---
Total anti-dilutive shares		79		64		170		69		163

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Note 2: Recently Issued Accounting Standards

In June 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-05 Comprehensive Income (Topic 220) Presentation of Comprehensive Income. The ASU improves the comparability, consistency, and transparency of financial reporting and increases the prominence of items reported in other comprehensive income. The amendments to Topic 220, Comprehensive Income, require entities to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Entities are no longer permitted to present components of other comprehensive income as part of the statement of changes in stockholders' equity. Any adjustments for items that are reclassified from other comprehensive income to net income are to be presented on the face of the entities' financial statement regardless of the method of presentation for comprehensive income. The amendments do not change items to be reported in comprehensive income or when an item of other comprehensive income must be reclassified to net income, nor do the amendments change the option to present the components of other comprehensive income either net of related tax effects or before related tax effects. ASU 2011-05 is effective for fiscal years, and interim periods beginning on or after December 15, 2011. We do not expect this ASU to have an impact on our financial condition or result of operations as it affects presentation only.

In May 2011, the FASB issued ASU No. 2011-04 Fair Value Measurement (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The ASU improves the comparability of fair value measurements presented and disclosed in accordance with U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRSs) by changing the wording used to describe many of the requirements in U.S GAAP for measuring fair value and disclosure of information. The amendments to this ASU provide explanations on how to measure fair value but do not require any additional fair value measurements and do not establish valuation standards or affect valuation practices outside of financial reporting. The amendments clarify existing fair value measurements and disclosure requirements to include application of the highest and best use and valuation premises concepts; measuring fair value of an instrument classified in a reporting entity's shareholders' equity; and disclosures requirements regarding quantitative information about unobservable inputs categorized within Level 3 of the fair value hierarchy. In addition, clarification is provided for measuring the fair value of financial instruments that are managed in a portfolio and the application of premiums and discounts in a fair value measurement. For public entities, ASU 2011-04 is effective during interim and annual periods beginning after December 15, 2011. We do not expect this ASU to have a significant impact on our financial condition or result of operations.

In April 2011, the FASB issued ASU No. 2011-02, Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. The ASU clarifies which loan modifications constitute troubled debt restructurings. It is intended to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to be considered a troubled debt restructuring ("TDR"), both for purposes of recording an impairment loss and for disclosure of a TDR. In evaluating whether a restructuring constitutes a TDR, a creditor must separately conclude that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. The amendments to ASU Topic 310, Receivables, clarify the guidance on a creditor's evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties. ASU No. 2011-02 is effective for interim and annual periods beginning on or after June 15, 2011, and applies retrospectively to restructurings occurring on or after the beginning of the fiscal year of adoption. We do not expect this ASU to have a significant impact on our financial condition or result of operations.

In December 2010, the FASB issued ASU No. 2010-29, Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations to address diversity in practice about the interpretation of the pro forma revenue and earnings disclosure requirements for business combinations. This ASU is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning January 1, 2011. It requires a public entity to disclose pro forma revenue and earnings of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period. If comparative financial statements are presented, the pro forma revenue and earnings of the combined entity for the comparable prior reporting period should be reported as though the acquisition date for all business combinations that occurred during the current year had been as of the beginning of the comparable prior annual reporting period. The amendments also expand the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. We have provided the applicable disclosure in Note 3 herein.

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In December 2010, the FASB also issued ASU No. 2010-28, Intangibles—Goodwill and Other (Topic 350), When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts. The amendments in this ASU affect all entities that have recognized goodwill and have one or more reporting units whose carrying amount for purposes of performing Step 1 of the goodwill impairment test is zero or negative. The amendments in this ASU modify Step 1 so that for those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with existing guidance, which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The above two ASUs did not have a significant impact on our financial condition or results of operations.

In July 2010, the FASB issued ASU No. 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. The ASU amends FASB Accounting Standards Codification™ (the “Codification” or “ASC”) Topic 310, Receivables, to improve the disclosures about the credit quality of an entity’s financing receivables and the related allowance for credit losses. As a result of these amendments, an entity is required to disaggregate, by portfolio segment or class of financing receivable, certain existing disclosures and provide certain new disclosures about its financing receivables and related allowance for credit losses.

Existing disclosures are amended to require an entity to provide the following disclosures about its financing receivables on a disaggregated basis:

(1) A rollforward schedule of the allowance for credit losses from the beginning of the reporting period to the end of the reporting period on a portfolio segment basis, with the ending balance further disaggregated on the basis of the impairment method;

(2) For each disaggregated ending balance in item (1) above, the related recorded investment in financing receivables;

(3) The nonaccrual status of financing receivables by class of financing receivables;

(4) Impaired financing receivables by class of financing receivables.

The amendments in the ASU also require an entity to provide the following additional disclosures about its financing receivables:

(1) Credit quality indicators of financing receivables at the end of the reporting period by class of financing receivables;

(2) The aging of past due financing receivables at the end of the reporting period by class of financing receivables;

(3) A description of the entity’s accounting policies and methodology used to estimate the allowance for credit losses by portfolio segments;

(4) The nature and extent of TDR that occurred during the period by class of financing receivables and their effect on the allowance for credit losses, as well as the nature and extent of financing receivables modified as TDR within the previous twelve months that defaulted during the reporting period by class of financing receivables and their effect on the allowance for credit losses; and

(5) Significant purchases and sales of financing receivables during the reporting period disaggregated by portfolio segments.

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The disclosures were effective for interim and annual reporting periods ended December 31, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods that began January 1, 2011. We have provided for the relevant disclosures in Note 6. As this ASU is disclosure-related only, it did not have an impact on our financial condition or results of operations.

Note 3: Acquisition

On February 18, 2011, we entered into a modified whole-bank purchase and assumption agreement without loss share (the "P&A Agreement") with the Federal Deposit Insurance Corporation (the "FDIC"), the receiver of Charter Oak Bank of Napa, California, to purchase certain assets and assume certain liabilities of the former Charter Oak Bank to enhance our market presence (the "Acquisition"). The purchase price reflected an asset discount of $19.8 million and no deposit premium.

The P&A Agreement only covers designated assets and liabilities of Charter Oak Bank. Common stock of Charter Oak Bank, certain assets and certain liabilities, such as claims against any officer, director, employee, accountant, attorney, or any other person employed by the former Charter Oak Bank, were not purchased or assumed by us. In addition, loans of the former Charter Oak Bank at their book values totaling approximately $24.4 million as of the acquisition date were retained by the FDIC. The excluded loans mainly represent loans delinquent more than sixty days or more as of the bid valuation date (October 18, 2010) and certain types of land and construction loans.

The assets acquired and liabilities assumed, both tangible and intangible, were recorded at their fair values as of acquisition date in accordance with ASC 805, Business Combinations. These fair value estimates are subject to change for up to one year after the acquisition date as additional information relative to acquisition date fair values becomes available. In addition, the tax treatment of FDIC-assisted acquisitions is complex and subject to interpretations that may result in future adjustments of deferred taxes as of the acquisition date.

In FDIC-assisted transactions, only certain assets and liabilities are transferred to the acquirer and, depending on the nature and amount of the acquirer's bid, the FDIC may be required to make a cash payment to the acquirer or the acquirer may be required to make payment to the FDIC. We received cash totaling $32.6 million from the FDIC upon initial settlement of the transaction and recorded a receivable from the FDIC of $196 thousand (included in other assets on the consolidated statements of condition), for consideration of the net liabilities assumed (i.e., the net difference between the liabilities assumed and the assets acquired). This amount is receivable within one year of the acquisition date and is outstanding at June 30, 2011.

The following table presents the net liabilities assumed from Charter Oak and the estimated fair value adjustments, which resulted in a bargain purchase gain as of the acquisition date as the loans were purchased at a discount:

(Dollars in thousands, unaudited)	Acquisition Date (February 18, 2011)
Book value of net liabilities assumed from Charter Oak Bank	$ (15,750)
Cash received from the FDIC upon initial settlement	32,588
Receivable from the FDIC	196
Fair value adjustments:	
Loans	(17,406)
Core deposit intangible asset	725
Vehicles and equipment	16

Deferred tax liabilities		(62)
Deposits		(220)
Advances from the Federal Home Loan Bank		(2)
Total purchase accounting adjustments		(16,949)
Bargain purchase gain, net of tax	$	85

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The bargain purchase gain represents the excess of the estimated fair value of the assets acquired over the estimated fair value of the liabilities assumed. We did not immediately acquire the banking facilities, including outstanding lease agreements, furniture, fixtures and equipment, as part of the P&A Agreement as of the acquisition date. We have since acquired all data processing equipment and the Napa branch fixed assets of $206 thousand and renegotiated a new lease with the landlord. The smaller St. Helena branch acquired from Charter Oak Bank was closed effective April 29, 2011.

The following table reflects the estimated fair values of the assets acquired and liabilities assumed related to the Acquisition, including cash received and receivable from the FDIC on the acquisition date:

(Dollars in thousands, unaudited)	Acquisition Date (February 18, 2011)
Assets:	
Cash and due from banks	$ 34,144
Interest bearing deposits in banks	5,663
Federal funds sold	4,235
Total cash and cash equivalents	44,042
Loans	61,765
Core deposit intangible	725
Other assets (including the receivable from the FDIC)	1,231
Total assets acquired	107,763
Liabilities:	
Deposits:	
Noninterest bearing	27,874
Interest bearing	65,987
Total deposits	93,861
Advances from the Federal Home Loan Bank	13,502
Deferred tax liabilities	62
Other liabilities	253
Total liabilities assumed	107,678
Bargain purchase gain, net of tax (included in other non-interest income)	$ 85

The following is a description of the methods used to determine the acquisition date fair values of significant assets and liabilities presented above.

Loans

The fair values for acquired loans were developed based upon the present values of the expected cash flows utilizing market-derived discount rates. Expected cash flows for each acquired loan were projected based on contractual cash flows adjusted for expected prepayment, expected default (i.e. probability of default and loss severity), and principal recovery.

For purchased non-credit-impaired loans, prepayment rates were applied to the principal outstanding based on the following assumptions depending on type of loan:

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For commercial and agriculture loans, a ten percent constant prepayment rate ("CPR") was assumed based on current research associated with these loan types;

- A one percent CPR was assumed for commercial real estate, construction and land loans as research data indicate limited prepayment activity over the life of these loans;
- For single family residential loans, a twenty percent CPR was used, based on current research associated with these loan types;
- For home equity lines of credit, a CPR of fifteen percent was assumed based on the refinance likelihood and other research; and,
- For other consumer loans, a CPR of one and a half percent was used based on current capital markets research data for consumer unsecured credit.

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Prepayment assumptions were not factored into the calculation of expected cash flows on purchased credit-impaired loans. For purchased non-credit impaired loans, the total gross contractual amounts receivable were $69.7 million as of the acquisition date.

Loans with similar characteristics were grouped together and were treated in the aggregate when applying the discount rate on the expected cash flows. Aggregation factors considered include the type of loan and related collateral, risk classification, fixed or variable interest rate, term of loan and whether or not the loan was amortizing. The discount rates used for the similar groups of loans are based on current market rates for new originations of comparable loans, where available, and include adjustments for credit and liquidity factors. To the extent comparable market rates are not readily available, a discount rate was derived based on the assumptions of a market participant's cost of funds, servicing costs, and return requirements for comparable risk assets.

Deposits

The fair values used for the transaction, savings and money market deposits are equal to the amount payable on demand at the reporting date. The fair values for time deposits are estimated using a discounted cash flow calculation that applies interest rates offered by market participants as of the acquisition date on time deposits with similar maturity terms as the discount rates. The core deposit intangible assets recognized as a result of the acquisition of core deposits are deductible for income tax purposes over fifteen years.

Advances from the Federal Home Loan Bank

The advances from the Federal Home Loan Bank San Francisco (“FHLB”) were recorded at their estimated fair value, which was based on quoted prices supplied by the FHLB. Subsequent to the acquisition dates, all of these advances were repaid in full.

Pro Forma Results of Operations

The contribution of the acquired operations of the former Charter Oak Bank to our results of operations for the period February 18 to June 30, 2011 is as follows: revenue of $5.4 million, expenses of $3.0 million (including a provision for loan losses of $994 thousand) and income after income taxes of $1.5 million. These amounts include the bargain purchase gain, acquisition-related costs, accretion of the discount on the acquired loans, and amortization of the fair value mark on time deposits and the core deposit intangible amortization. Charter Oak Bank’s results of operations prior to the acquisition date are not included in our operating results for 2011.

We acquired only certain assets and assumed certain liabilities from the former Charter Oak Bank. A significant portion of the former Charter Oak Bank’s operations, including certain delinquent loans, its St. Helena facilities and its central operations and administrative functions were not retained by us. Therefore, disclosure of supplemental pro forma financial information, especially prior period comparison is deemed neither practical nor meaningful given the troubled nature of Charter Oak Bank prior to the date of Acquisition.

Acquisition-related expenses are recognized as incurred and continue until all systems have been converted and operational functions become fully integrated. We incurred third-party acquisition-related expenses in the following line items in the consolidated statements of income for the three month and six month periods ended June 30, 2011 as follows:

Acquisiton-related Expenses (in thousands)	Three months ended June 30, 2011	Six months ended June 30, 2011

Professional services	$ 153	$ 457
Data processing	378	408
Other	111	125
Total	$ 642	$ 990

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Note 4: Fair Value of Assets and Liabilities

Fair Value Hierarchy and Fair Value Measurement

We group our assets and liabilities that are recorded at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1: Valuations are based on quoted prices in active markets for identical assets or liabilities. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not involve a significant degree of judgment.

Level 2: Valuations are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuations for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3: Valuations are based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Values are determined using pricing models and discounted cash flow models and includes management judgment and estimation which may be significant.

The following table summarizes our assets and liabilities that were required to be recorded at fair value on a recurring basis.

(in thousands) Description of Financial Instruments	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Balance at June 30, 2011 (unaudited):				
Securities available for sale:				
Mortgage-backed securities and collaterized mortgage obligations issued by U.S. government agencies	$119,507	$---	$ 119,507	$ ---
Debentures of government sponsored agencies	$29,893	$---	$ 29,893	$ ---
Corporate collateralized mortgage obligations	$18,006	$---	$ 18,006	$ ---
Derivative financial liabilities (interest rate contracts)	$2,691	$---	$ 2,691	$ ---
Balance at December 31, 2010:				
Securities available for sale:				
Mortgage-backed securities and collaterized mortgage obligations issued by U.S. government agencies	$95,258	$---	$ 95,258	$ ---
Corporate collateralized mortgage obligations	$15,870	$---	$ 15,870	$ ---
Equity securities	$608	$608	$ -	$ ---
Derivative financial liabilities (interest rate contracts)	$2,470	$---	$ 2,470	$ ---

Securities available for sale are recorded at fair value on a recurring basis. When available, quoted market prices (Level 1) are used to determine the fair value of securities available for sale. If quoted market prices are not available, we obtain pricing information from a reputable third-party service provider, who may utilize valuation techniques that use current market-based or independently sourced parameters, such as bid/ask prices, dealer-quoted prices, interest rates, benchmark yield curves, prepayment speeds, and credit spreads (Level 2). Level 1 securities include those traded on active markets, including U.S. Treasury securities and equity securities. Level 2 securities include U.S. agencies' debt securities, mortgage-backed securities, and corporate collateralized mortgage obligations.

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On a recurring basis, derivative financial instruments are recorded at fair value, which is based on the income approach using observable Level 2 market inputs, reflecting market expectations of future interest rates as of the measurement date. Standard valuation techniques are used to calculate the present value of the future expected cash flows assuming an orderly transaction. Valuation adjustments may be made to reflect both our own credit risk and the counterparties' credit quality in determining the fair value of the derivatives. Level 2 inputs for the valuations are limited to observable market prices for London Interbank Offered Rate ("LIBOR") cash rates (for the very short term), quoted prices for LIBOR futures contracts, observable market prices for LIBOR swap rates, and one-month and three-month LIBOR basis spreads at commonly quoted intervals. Mid-market pricing of the inputs is used as a practical expedient in the fair value measurements. Key inputs for interest rate valuations are used to project spot rates at resets specified by each swap, as well as to discount those future cash flows to present value at the measurement date. When the value of any collateral placed with counterparties is less than the interest rate derivative liability, the interest rate liability position is further discounted to reflect our potential credit risk to counterparties. We have used the spread between the Standard & Poors BBB rated U.S. Bank Composite rate and LIBOR with maturity term corresponding to the duration of the swaps to calculate this credit-risk-related discount of future cash flows.

Certain financial assets may be measured at fair value on a non-recurring basis. These assets are subject to fair value adjustments that result from the application of the lower of cost or fair value accounting or write-downs of individual assets. For example, when a loan is identified as impaired, it is reported at the lower of cost or fair value, measured based on the loan's observable market price (Level 1), the present value of expected future cash flows discounted at a market-based interest rate for similar loans (Level 2), or the current appraised value of the underlying collateral securing the loan if the loan is collateral dependent (Level 3). Securities held to maturity may be written down to fair value (determined using the same techniques discussed above for securities available for sale) as a result of an other-than-temporary impairment, if any.

The following table presents the carrying value of financial instruments by level within the fair value hierarchy as of June 30, 2011 and December 31, 2010, for which a non-recurring change in fair value has been recorded.

(in thousands) Description of Financial Instruments	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3) (a)	Losses for the three months ended June 30, 2011 (b)	Losses for the six months ended June 30, 2011 (b)	Losses for the three months ended June 30, 2010 (b)	Losses for the six months ended June 30, 2010 (b)
At June 30, 2011 (unaudited):								
Impaired loans carried at fair value (c)	$3,585	$ ---	$ ---	$ 3,585	$2,870	$4,083	$557	$2,200
At December 31, 2010:								
Impaired loans carried at fair value (c)	$8,635	$ ---	$ ---	$ 8,635				

(a) Represents collateral-dependent loan principal balances that had been generally written down to the appraised value or estimated market value of the underlying collateral, net of specific valuation allowance of $1.2 million and $936 thousand at June 30, 2011 and December 31, 2010, respectively. The carrying value of loans fully charged-off, which includes unsecured lines of credit, overdrafts and all other loans, is zero.

(b) Represents net charge-offs during the period presented and the specific valuation allowance established on loans during the period.

(c) Represents the portion of impaired loans that have been written down to their estimated fair value.

Disclosures about Fair Value of Financial Instruments

The table below is a summary of fair value estimates for financial instruments as of June 30, 2011 and December 31, 2010, excluding financial instruments recorded at fair value on a recurring basis (summarized in a separate table). The carrying amounts in the following table are recorded in the statements of condition under the indicated captions. We have excluded non-financial assets and non-financial liabilities defined by the Codification (ASC 820-10-15-1A), such as Bank premises and equipment, deferred taxes and other liabilities. In addition, we have not disclosed the fair value of financial instruments specifically excluded from disclosure requirements of the Financial Instruments Topic of the Codification (ASC 825-10-50-8), such as Bank-owned life insurance policies.

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	June 30, 2011		December 31, 2010	
(in thousands; 2011 amounts unaudited)	Carrying Amounts	Fair Value	Carrying Amounts	Fair Value
Financial assets				
Cash and cash equivalents	$110,159	$110,159	$85,232	$85,232
Investment securities held to maturity	35,514	36,914	34,917	35,090
Loans, net	972,714	989,175	929,008	952,763
Interest receivable	4,403	4,403	4,207	4,207
Financial liabilities				
Deposits	1,138,906	1,139,716	1,015,739	1,016,401
Federal Home Loan Bank borrowings	55,000	57,088	55,000	57,090
Subordinated debenture	5,000	5,123	5,000	4,994
Interest payable	439	439	414	414

Following is a description of methods and assumptions used to estimate the fair value of each class of financial instrument not recorded at fair value but required for disclosure purposes:

Cash and Cash Equivalents – The carrying amounts of cash and cash equivalents approximate their fair value because of the short-term nature of these instruments.

Held-to-maturity Securities - Held-to-maturity securities, which generally consist of obligations of state & political subdivisions, are recorded at their amortized cost. Their fair value for disclosure purposes is determined using methodologies similar to those described above for available-for-sale securities using Level 2 inputs. If Level 2 inputs are not available, we may utilize pricing models that incorporate unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities (Level 3). As of June 30, 2011, we did not hold any securities whose fair value was measured using significant unobservable inputs.

Loans - The fair value of loans with variable interest rates approximates their current carrying value, because their rates are regularly adjusted to current market rates. The fair value of fixed rate loans or variable loans at negotiated interest rate floors or ceilings with remaining maturities in excess of one year is estimated by discounting the future cash flows using current market rates at which similar loans would be made to borrowers with similar credit worthiness and similar remaining maturities. The allowance for loan losses (“ALLL”) is considered to be a reasonable estimate of loan discount due to credit risks.

Interest Receivable and Payable - The interest receivable and payable balances approximate their fair value due to the short-term nature of their settlement dates.

Deposits - The fair value of non-interest bearing deposits, interest bearing transaction accounts, savings accounts and money market accounts is the amount payable on demand at the reporting date. The fair value of time deposits is estimated by discounting the future cash flows using current rates offered for deposits of similar remaining maturities.

Federal Home Loan Bank Borrowings - The fair value is estimated by discounting the future cash flows using current rates offered by the FHLB for similar credit advances corresponding to the remaining duration of our fixed-rate credit advances.

Subordinated Debenture - The fair value of the subordinated debenture is estimated by discounting the future cash flows (interest payment at a rate of three-month LIBOR plus 2.48%) using current market rates at which similar bonds would be issued with similar credit ratings as ours and similar remaining maturities. We have used the spread of the ten-year BBB rated U.S. Bank Composite over LIBOR to calculate this credit-risk-related discount of future cash flows.

Commitments - Loan commitments and standby letters of credit generate ongoing fees, which are recognized over the term of the commitment period. In situations where the borrower's credit quality has declined, we record a reserve for these off-balance sheet commitments. Given the uncertainty in the likelihood and timing of a commitment being drawn upon, a reasonable estimate of the fair value of these commitments is the carrying value of the related unamortized loan fees plus the reserve, which is not material.

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Note 5: Investment Securities

Our investment securities portfolio consists primarily of U.S. government agency securities, including mortgage-backed securities ("MBS") and collateralized mortgage obligations ("CMOs") issued or guaranteed by FNMA, FHLMC, or GNMA. Our portfolio also includes obligations of state and political subdivisions, debentures issued by government-sponsored agencies such as FHLB, as well as corporate CMOs and equity securities, as reflected in the table below.

	June 30, 2011				December 31, 2010			
			Gross Unrealized				Gross Unrealized	
(in thousands; June 30, 2011 unaudited)	Amortized Cost	Fair Value	Gains	(Losses)	Amortized Cost	Fair Value	Gains	(Losses)
Held-to-maturity								
Obligations of state and political subdivisions	$35,514	$36,914	$1,526	$(126)	$34,917	$35,090	$666	$(493)
Available-for-sale								
Securities of U. S. government agencies:								
MBS pass-through securities issued by FNMA and FHLMC	27,824	28,425	652	(51)	16,119	16,424	419	(114)
CMOs issued by FNMA	11,749	12,229	480	---	12,770	13,236	466	---
CMOs issued by FHLMC	21,680	22,245	565	---	19,725	20,177	452	---
CMOs issued by GNMA	55,528	56,608	1,082	(2)	44,607	45,421	884	(70)
Debentures of government sponsored agencies	29,850	29,893	55	(12)	---	---	---	---
Corporate CMOs	18,100	18,006	145	(239)	15,849	15,870	185	(164)
Equity security	---	---	---	---	---	608	608	---
Total available for sale	164,731	167,406	2,979	(304)	109,070	111,736	3,014	(348)
Total investment securities	$200,245	$204,320	$4,505	$(430)	$143,987	$146,826	$3,680	$(841)

As a member bank of Visa U.S.A., we hold 16,939 shares of Visa Inc. Class B common stock at a zero cost basis. These shares are restricted from resale until their conversion into Class A (voting) shares upon the termination of Visa Inc.'s covered litigation escrow account. The conversion rate will be determined upon the final resolution of the Visa Inc. covered litigation described in Note 13 to the Consolidated Financial Statements in our 2010 Form 10-K. The stock was re-classified from available-for-sale securities to cost-basis accounting in March 2011 as the stock is still currently restricted from resale based on new information received from Visa Inc. Hence, the unrealized gain on the stock, net of tax, at December 31, 2010 was reversed from other comprehensive income. The fair value of the Class B common stock we own was $697 thousand and $608 thousand at June 30, 2011 and December 31, 2010, respectively, based on the Class A as-converted rate of 0.4881 and 0.5102, respectively.

The amortized cost and fair value of investment securities by contractual maturity at June 30, 2011 are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	June 30, 2011			
	Held to Maturity		Available for Sale	
(in thousands; unaudited)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	$1,471	$1,480	$---	$---
After one but within five years	7,494	7,747	23,293	23,376
After five years through ten years	19,596	20,541	22,992	23,304
After ten years	6,953	7,146	118,446	120,726
Total	$35,514	$36,914	$164,731	$167,406

At June 30, 2011, investment securities carried at $50.1 million were pledged with the State of California: $49.3 million to secure public deposits in compliance with the Local Agency Security Program and $662 thousand to provide collateral for trust deposits. In addition, at June 30, 2011, investment securities carried at $1.4 million were pledged to collateralize an internal Wealth Management Services checking account and $3.4 million were pledged to collateralize interest rate swaps as discussed in Note 11.

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Other-Than-Temporarily Impaired Debt Securities

For each security in an unrealized loss position, we assess whether we intend to sell the security, or it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other-than-temporarily impaired and that we do not intend to sell and will not be required to sell prior to recovery of our amortized cost basis, we separate the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is calculated as the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of future expected cash flows is deemed to be due to factors that are not credit related and is recognized in other comprehensive income.

We do not have the intent to sell the securities that are temporarily impaired, and it is more likely than not that we will not have to sell those securities before recovery of the cost basis. Additionally, we have evaluated the credit ratings of our investment securities and their issuers and/or insurers, if applicable. Based on our evaluation, Management has determined that no investment security in our investment portfolio is other-than-temporarily impaired.

Sixteen and twenty-nine investment securities were in unrealized loss positions at June 30, 2011 and December 31, 2010, respectively. They are summarized and classified according to the duration of the loss period as follows:

June 30, 2011	< 12 continuous months		> 12 continuous months		Total Securities in a loss position	
(In thousands; unaudited)	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
Held-to-maturity						
Obligations of state & political subdivisions	$346	$(1)	$1,804	$(125)	$2,150	$(126)
Available-for-sale						
Securities of U.S. government agencies	13,588	(65)	---	---	13,588	(65)
Corporate CMOs	11,827	(239)	---	---	11,827	(239)
Total available for sale	25,415	(304)	---	---	25,415	(304)
Total temporarily impaired securities	$25,761	$(305)	$1,804	$(125)	$27,565	$(430)

December 31, 2010	< 12 continuous months		> 12 continuous months		Total Securities in a loss position	
(In thousands)	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
Held-to-maturity						
Obligations of state & political subdivisions	$11,622	$(250)	$1,687	$(243)	$13,309	$(493)
Available-for-sale						
Securities of U.S. government agencies	12,888	(184)	---	---	12,888	(184)
Corporate CMOs	7,070	(164)	---	---	7,070	(164)
Total available for sale	19,958	(348)	---	---	19,958	(348)

Total temporarily impaired securities	$31,580	$(598)	$1,687	$(243)	$33,267	$(841)

The unrealized losses associated with debt securities of U.S. government agencies are primarily driven by changes in interest rates and not due to the credit quality of the securities. Further, securities backed by GNMA, FNMA, or FHLMC have the guarantee of the full faith and credit of the U.S. Federal Government. Obligations of U.S. states and political subdivisions in our portfolio are all investment grade without delinquency history. The security in a loss position for more than twelve continuous months relates to one debenture issued by a local subdivision with payments collected through property tax assessments in an affluent community. This security will continue to be monitored as part of our ongoing impairment analysis, but is expected to perform. As a result, we concluded that this security was not other-than-temporarily impaired at June 30, 2011.

The unrealized losses associated with corporate CMO's are primarily related to securities backed by residential mortgages. Most of these securities were AAA rated by at least one major rating agency. We estimate loss projections for each security by assessing loans collateralizing the security and determining expected default rates and loss severities. Based upon our assessment of expected credit losses of each security given the performance of the underlying collateral and credit enhancements where applicable, we concluded that these securities were not other-than-temporarily impaired at June 30, 2011.

Securities Carried at Cost

As a member of the FHLB, we are required to maintain a minimum investment in the FHLB capital stock determined by the Board of Directors of the FHLB. The minimum investment requirements can also increase in the event we need to increase our borrowing capacity with the FHLB. Shares cannot be purchased or sold except between the FHLB and its members at its $100 per share par value. We held $5.4 million and $5.0 million of FHLB stock recorded at cost in other assets at June 30, 2011 and December 31, 2010, respectively. On April 28, 2011, FHLB declared a cash dividend for the first quarter of 2011 at an annualized dividend rate of 0.31%. Management expects to be able to redeem this stock at cost, and therefore does not believe the FHLB stock to be other-than-temporarily impaired.

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Note 6: Loans and Allowance for Loan Losses

Credit Quality of Loans

Outstanding loans by class and payment aging, excluding credit-impaired loans purchased in the Acquisition accounted for under ASC 310-30 ("PCI" loans) of $7.2 million that have not experienced credit deterioration post acquisition as of June 30, 2011, are as follows:

Loan Aging Analysis by Class As of June 30, 2011 and December 31, 2010

(Dollars in thousands; June 30, 2011 unaudited)	Commercial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential 1	Installment and other consumer	Total
June 30, 2011								
30-59 days past due	$ 272	$ -	$ -	$ -	$-	$-	$ 289	$561
60-89 days past due	200	-	-	-	-	-	2	202
Greater than 90 days past due (non-accrual) 2	3,669	293	-	3,263	710	138	621	8,694
Total past due	4,141	293	-	3,263	710	138	912	9,457
Current	171,536	160,833	388,796	63,241	94,502	66,748	24,326	969,982
Total loans 3	$ 175,677	$ 161,126	$ 388,796	$ 66,504	$95,212	$66,886	$ 25,238	$979,439
Non-accrual loans to total loans	2.1 %	0.2 %	-	4.9 %	0.7 %	0.2 %	2.5 %	0.9 %
Troubled debt restructured loans 4								
Accruing	$ -	$ -	$ -	$ -	$164	$238	$ 1,136	$1,538
Non-accrual	41	-	-	-	-	-	53	94
Total troubled debt restructured loans	$ 41	$ -	$ -	$ -	$164	$238	$ 1,189	$1,632
December 31, 2010								
30-59 days past due	$ 20	$ -	$ -	$ -	$25	$-	$ 307	$352
60-89 days past due	-	-	-	-	-	-	-	-
Greater than 90 days past due (non-accrual) 2	2,486	632	-	9,297	-	148	362	12,925
Total past due	2,506	632	-	9,297	25	148	669	13,277

Current	151,330	141,958	383,553	68,322	86,907	69,843	26,210	928,123
Total loans 3	$ 153,836	$ 142,590	$ 383,553	$ 77,619	$ 86,932	$ 69,991	$ 26,879	$ 941,400
Non-accrual loans to total loans	1.6 %	0.4 %	-	12.0 %	-	0.2 %	1.3 %	1.4 %
Troubled debt restructured loans 4								
Accruing	$ -	$ -	$ -	$ -	$ 259	$ -	$ 925	$ 1,184
Non-accrual	-	-	-	-	-	-	55	55
Total troubled debt restructured loans	$ -	$ -	$ -	$ -	$ 259	$ -	$ 980	$ 1,239

1 Our residential loan portfolio includes no sub-prime loans, nor is it our normal practice to underwrite loans commonly referred to as "Alt-A mortgages", the characteristics of which are loans lacking full documentation, borrowers having low FICO scores or higher loan-to-value ratios.
2 June 30, 2011 amounts include $701 thousand PCI loans that have experienced credit deterioration post-acquisition and exclude accreting PCI loans of $7.2 million, as their accretable yield interest recognition is independent from the underlying contractual loan delinquency status. There were no accruing loans past due more than 90 days at December 31, 2010.
3 Amounts were net of deferred loan fees of $1.9 million and $2.8 million at June 30, 2011 and December 31, 2010, respectively.
4 Defined as loans whose contractual terms have been restructured in a manner which grants a concession to a borrower experiencing financial difficulties. These balances are included in the impaired loan totals in the table below.

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Our commercial loans are generally made to established small to mid-sized businesses to provide financing for their working capital needs or acquisition of fixed assets. Management examines historical, current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial 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 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. We target stable local businesses with strong guarantors that have proven to be more resilient in periods of economic stress. Typically, the strong guarantors provide an additional source of repayment for our credit extensions.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans discussed above, in addition to those of real estate loans. We underwrite these loans primarily as cash flow loans and secondarily as loans secured by real estate. Repayment of commercial real estate loans is largely dependent on the successful operation of the property securing the loan, or the business conducted on the property securing the loan. Underwriting standards for these loans typically meet a minimum debt coverage ratio of 1.20:1.00, and a loan-to-value of 65% or less. Furthermore, substantially all of our loans are guaranteed by the owners of the properties. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. In the event of a vacancy, strong guarantors have historically carried the loans until a replacement tenant can be found. The owner’s substantial equity investment provides a strong economic incentive to continue to support the commercial real estate projects. As such, we experience nominal delinquencies in this portfolio.

Construction loans are generally made to developers and builders to finance land acquisition as well as the subsequent construction. These loans are underwritten after evaluating of the borrower's financial strength, reputation, prior track record and obtaining independent appraisal reviews. The construction industry can be severely impacted by several major factors, including: 1) the inherent volatility of real estate markets; 2) vulnerability to weather delays, labor, or material shortages and price hikes; and, 3) generally thin margins and tight cash flow. Estimates of construction costs and value associated with the complete project may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project.

Consumer loans primarily consist of home equity lines of credit and loans, other residential (tenancy-in-common, or “TIC”) loans and other personal loans. We originate consumer loans utilizing credit score information, debt-to-income ratio and loan-to-value ratio analysis. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed. 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 include, but are not limited to, a maximum loan-to-value percentage of 75% of loans that are $1,250,000 or less (and even more conservatively for homes with values in excess of this amount), collection remedies, the number of such loans a borrower can have at one time and documentation requirements. Our underwriting of the other residential loans, mostly secured by TIC units in San Francisco, has been cautious compared to traditional residential mortgages due to the unique ownership structure and the interest-only feature of these loans. However, these borrowers tend to have more equity in their properties, which mitigates risk. Personal loans are nearly evenly split between mobile home loans and floating home loans along with a small number of direct auto loans and installment loans. Personal unsecured loans are offered to consumers with additional underwriting procedures in place, including net worth, and borrowers’ verified liquid assets analysis. In general, personal loans usually have a higher degree of risk than other types of loans.

We use a risk rating system as a tool used to evaluate asset quality, and to identify and monitor credit risk in individual loans, and ultimately in the portfolio. Definitions of risk grades of “Special Mention” or worse loans are consistent with those used by the banking regulators. Our internally assigned grades are as follows:

Pass – Loans to borrowers of acceptable or better credit quality. Borrowers in this category demonstrate fundamentally sound financial positions, repayment capacity, credit history and management expertise. Loans in this category must have an identifiable and stable source of repayment and meet the Bank’s policy regarding debt service coverage ratios. These borrowers are capable of sustaining normal economic, market or operational setbacks without significant financial impacts. Financial ratios and trends are acceptable. Negative external industry factors are generally not present. The loan may be secured, unsecured or supported by non-real estate collateral for which the value is more difficult to determine and/or marketability is more uncertain. This category also includes “Watch” loans, where the primary source of repayment has been delayed. “Watch” is intended to be a transitional grade, with either an upgrade or downgrade within a reasonable period.

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Special Mention - Potential weaknesses that deserve close attention. If left uncorrected, those potential weaknesses may result in deterioration of the payment prospects for the asset. Special Mention assets do not present sufficient risk to warrant adverse classification.

Substandard - Inadequately protected by either the current sound worth and paying capacity of the obligor or the collateral pledged, if any. A Substandard asset has a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Substandard assets are characterized by the distinct possibility that we will sustain some loss if such weaknesses or deficiencies are not corrected. Loss potential, while inherent in the aggregate substandard amount, does not necessarily exist in the individual assets classified Substandard. Well-defined weaknesses include adverse trends or developments of the borrower’s financial condition, managerial weaknesses and/or significant collateral deficiencies.

Doubtful - Critical weaknesses that make collection or liquidation in full improbable. There may be specific pending events that work to strengthen the asset, however, the amount or timing of the loss may not be determinable. Pending events generally occur within one year of the asset being classified as Doubtful. Examples include: merger, acquisition, or liquidation; capital injection; guarantee; perfecting liens on additional collateral; and refinancing. Such loans are placed on non-accrual status and usually are collateral-dependant.

We regularly review our credits for accuracy of risk grades whenever new financial information is received. Borrowers are required to submit financial information at regular intervals:

- Generally, commercial borrowers with lines of credit are required to submit financial information with reporting intervals ranging from monthly to annually depending on credit size, risk and complexity.
- Investor commercial real estate borrowers with loans greater than $2.5 million are required to submit rent rolls or property income statements at least annually. It has been our practice to obtain rent rolls or property income statements for loans $750 thousand or greater for the last two years.
- Construction loans are monitored monthly, and assessed on an ongoing basis.
- Home equity and other consumer loans are assessed based on delinquency.
- Loans graded “Watch” or more severe, regardless of loan type, are assessed no less than quarterly.

The following table represents our analysis of loans by internally assigned grades as of June 30, 2011, including the PCI loans, and December 31, 2010:

Credit Quality Indicators As of June 30, 2011 and December 31, 2010

(Dollars in thousands; June 30, 2011 unaudited)	Commercial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Purchased credit-impaired	Total
Credit Risk Profile by Internally Assigned Grade:									
June 30, 2011									
Pass	$ 146,011	$ 150,538	$ 376,333	$ 43,509	$ 91,583	$ 60,746	$ 24,309	$ 1,553	$ 894,582
Special mention	7,217	2,439	6,538	2,979	430	1,328	171	773	21,875
Substandard	17,723	7,558	5,925	19,783	2,246	4,730	497	5,249	63,711
Doubtful	4,115	502	-	233	953	82	261	320	6,466
Total loans	$ 175,066	$ 161,037	$ 388,796	$ 66,504	$ 95,212	$ 66,886	$ 25,238	$ 7,895	$ 986,634

December 31, 2010									
Pass	$ 120,428	$ 135,443	$ 369,975	$ 57,779	$ 84,830	$ 64,570	$ 26,280	$ -	$ 859,305
Special mention	17,009	454	330	10,253	447	-	-	-	28,493
Substandard	16,169	6,693	13,248	9,587	1,655	5,421	427	-	53,200
Doubtful	230	-	-	-	-	-	172	-	402
Total loans	$ 153,836	$ 142,590	$ 383,553	$ 77,619	$ 86,932	$ 69,991	$ 26,879	$ -	$ 941,400

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Impaired loan balances and their related allowance by major classes of loans

The table below summarizes information on impaired loans and their related ALLL. The information below excludes $7.2 million PCI loans purchased in the Acquisition that have not experienced credit deterioration. Based on current information and events, it is probable that we will be able to collect all cash flows expected.

(Dollars in thousands; June 30, 2011 unaudited)	Commercial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Total
June 30, 2011								
Recorded investment in impaired loans:								
With no specific allowance recorded	$ 1,695	$ ---	$ ---	$ 265	$350	$ ---	$ 286	$2,596
With a specific allowance recorded	1,974	293	---	2,998	524	376	1,471	7,636
Total recorded investment in impaired loans	$ 3,669	$ 293	$ ---	$ 3,263	$874	$ 376	$ 1,757	$10,232
Unpaid principal balance of impaired loans:								
With no specific allowance recorded	$ 2,500	$ ---	$ ---	$ 265	$350	$ ---	$ 328	$3,443
With a specific allowance recorded	2,858	482	---	5,525	614	376	1,514	11,369
Total unpaid principal balance of impaired loans	$ 5,358	$ 482	$ ---	$ 5,790	$964	$ 376	$ 1,842	$14,812
Specific allowance	$ 1,537	$ 97	$ ---	$ 315	$183	$ 99	$ 409	$2,640
Average recorded investment in impaired loans during the quarter ended June 30, 2011	3,411	1,037	---	6,591	216	140	609	12,004
Interest income recognized on impaired loans during the quarter ended June 30, 2011	37	---	---	---	8	---	8	53
Average recorded investment in impaired loans during the six	2,920	836	---	7,591	112	143	506	12,108

months ended June 30, 2011								
Interest income recognized on impaired loans during the six months ended June 30, 2011	49	---	---	---	8	---	8	65
December 31, 2010								
Recorded investment in impaired loans:								
With no specific allowance recorded	$ 959	$ 633	$ ---	$ 8,742	$---	$ ---	$ 73	$10,407
With a specific allowance recorded	1,526	---	$ ---	555	259	148	1,214	3,702
Total recorded investment in impaired loans	$ 2,485	$ 633	$ ---	$ 9,297	$259	$ 148	$ 1,287	$14,109
Unpaid principal balance of impaired loans:								
With no specific allowance recorded	$ 959	$ 689	$ ---	$ 11,485	$---	$ ---	$ 115	$13,248
With a specific allowance recorded	2,570	---	---	555	259	148	1,214	4,746
Total recorded investment in impaired loans	$ 3,529	$ 689	$ ---	$ 12,040	$259	$ 148	$ 1,329	$17,994
Specific allowance	$ 667	$ ---	$ ---	$ 3	$25	$ 93	$ 290	$1,078
Average recorded investment in impaired loans during the year ended December 31, 2011	1,326	3,086	---	6,326	191	39	1,212	12,180
Interest income recognized on impaired loans during the year ended December 31, 2011	85	22	---	336	8	5	66	522

The gross interest income that would have been recorded had non-accrual loans been current totaled $177 thousand, $220 thousand and $243 thousand in the quarters ended June 30, 2011, March 31, 2011 and June 30, 2010 respectively and totaled $397 thousand and $479 thousand for the first half of 2011 and 2010, respectively. PCI loans are excluded from the data above as their accretable yield interest recognition is independent from the underlying contractual loan delinquency status. See page 24, “PCI Loans” for further discussion.

Management monitors delinquent loans continuously and identifies problem loans, generally loans graded substandard or worse, to be evaluated individually for impairment testing. Generally, we charge off our estimated losses related to specifically-identified impaired loans when it is deemed uncollectible. The charged-off portion of impaired loans outstanding at June 30, 2011 totaled approximately $3.6 million. At June 30, 2011, there were no significant commitments to extend credit on impaired loans, including loans to borrowers whose terms have been modified in troubled debt restructurings.

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The following table discloses loans by major portfolio category and the related ALLL disaggregated by impairment evaluation method as of June 30, 2011 and December 31, 2010, as well as activity in the ALLL for the three months and six months ended June 30, 2011:

Allowance for Loan Losses and Recorded Investment in Loans

(Dollars in thousands; 2011 unaudited)	Commercial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Unallocated	Total
For the three months ended June 30, 2011:									
Allowance for loan losses:									
Beginning balance	$3,053	$1,033	$4,026	$2,213	$853	$724	$921	$246	$13,069
Provision (reversal)	2,602	97	62	(88)	206	(18)	119	20	3,000
Charge-offs	(1,581)	-	-	(178)	(257)	-	(155)	-	(2,171)
Recoveries	17	-	-	-	-	-	5	-	22
Ending balance	$4,091	$1,130	$4,088	$1,947	$802	$706	$890	$266	$13,920
For the six months ended June 30, 2011:									
Allowance for loan losses:									
Beginning balance	$3,114	$1,037	$4,134	$1,694	$643	$738	$835	$197	$12,392
Provision (reversal)	2,823	93	(46)	454	416	(32)	273	69	4,050
Charge-offs	(1,873)	-	-	(201)	(257)	-	(229)	-	(2,560)
Recoveries	27	-	-	-	-	-	11	-	38
Ending balance	$4,091	$1,130	$4,088	$1,947	$802	$706	$890	$266	$13,920
As of June 30, 2011:									
Ending ALLL related to loans collectively evaluated for impairment	$2,554	$1,033	$4,088	$1,632	$619	$607	$481	$266	$11,280
	$1,179	$8	$-	$315	$183	$99	$409	$-	$2,193

Ending ALLL related to loans individually evaluated for impairment									
Ending ALLL related to purchased credit-impaired loans	$358	$89	$-	$-	$-	$-	$-	$-	$447
Loans outstanding:									
Collectively evaluated for impairment	$172,008	$160,834	$388,796	$63,241	$94,338	$66,509	$23,481	$-	$969,207
Individually evaluated for impairment	3,058	203	-	3,263	874	377	1,757	-	9,532
Purchased credit-impaired	2,189	3,953	1,753	-	-	-	-	-	7,895
Total	$177,255	$164,990	$390,549	$66,504	$95,212	$66,886	$25,238	$-	$986,634
Ratio of allowance for loan losses to total loans	2.31 %	0.68 %	1.05 %	2.93 %	0.84 %	1.06 %	3.53 %	-	1.41 %
Allowance for loan losses to non-accrual loans	112 %	386 %	NM	60 %	113 %	512 %	143 %	-	160 %
As of December 31, 2010:									
Ending ALLL related to loans collectively evaluated for impairment	$2,447	$1,037	$4,134	$1,691	$618	$645	$545	$197	$11,314
Ending ALLL related to loans individually evaluated for impairment	$667	$-	$-	$3	$25	$93	$290	$-	$1,078
Loans outstanding:									
Collectively evaluated for	$151,351	$141,957	$383,553	$68,322	$86,673	$69,843	$25,592	$-	$927,291

impairment									
Individually evaluated for impairment	2,485	633	-	9,297	259	148	1,287	-	14,109
Total	$153,836	$142,590	$383,553	$77,619	$86,932	$69,991	$26,879	$-	$941,400
Ratio of allowance for loan losses to total loans	2.02 %	0.73 %	1.08 %	2.18 %	0.74 %	1.05 %	3.11 %	-	1.32 %
Allowance for loan losses to non-accrual loans	125 %	164 %	NM	18 %	NA	499 %	231 %	-	96 %

1 Amount excludes $701 thousand PCI loans that have experienced credit deterioration post-acquisition, which are included in the "Purchased credit-impaired" amount in the next line below.

NM: Not meaningful.

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Activity in the allowance for loan losses for the three months and six months ended June 30, 2010 follows:

(Dollars in thousands; unaudited)	Three months ended June 30, 2010	Six months ended June 30, 2010
Allowance for loan losses:		
Beginning balance	$ 10,648	$ 10,618
Provision	1,350	2,900
Charge-offs	(241)	(1,788)
Recoveries	16	43
Ending balance	$ 11,773	$ 11,773
Average recorded investment in impaired loans during the period	$ 12,093	$ 12,225

	At June 30, 2010
Total loans outstanding , before deducting allowance for loan losses	$ 939,293
Ratio of allowance for loan losses to total loans	1.25 %
Allowance for loan losses to non-accrual loans	109.28 %
Non-accrual loans to total loans	1.15 %

Purchased Credit-Impaired Loans

During the first six months of 2011, we evaluated loans purchased in the Acquisition in accordance with accounting guidance in ASC 310-30 related to loans acquired with deteriorated credit quality. Acquired loans are considered credit-impaired if there is evidence of deterioration of credit quality since origination and it is probable, at the acquisition date, that we will be unable to collect all contractually required payments receivable. Management has determined certain loans purchased in the Acquisition to be PCI loans based on credit indicators such as nonaccrual status, past due status, loan risk grade, loan-to-value ratio, etc. Revolving credit agreements (e.g. home equity lines of credit and revolving commercial loans), if at the acquisition date the borrower had revolving privileges, are not considered PCI loans as cash flows cannot be reasonably estimated.

For acquired loans not considered credit-impaired, the difference between the contractual amounts due (principal amount) and the fair value is accounted for subsequently through accretion. We elect to recognize discount accretion based on the acquired loan’s contractual cash flows using an effective interest rate method. The accretion is recognized through the net interest margin as described in the guidance for accounting for loan origination fees and costs that is included in FASB ASC 310-20 (formerly FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases).

The following table presents the fair value of loans pursuant to accounting standards for purchased credit-impaired loans and other purchased loans as of the acquisition date:

	February 18, 2011
(Dollars in thousands; unaudited)	Purchased credit-impaired