SIERRA BANCORP
Form 10-Q
May 09, 2014

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES

EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2014

Commission file number: 000-33063

Sierra Bancorp

(Exact name of Registrant as specified in its charter)

California	33-0937517
(State of Incorporation)	(IRS Employer Identification No)

86 North Main Street, Porterville, California 93257

(Address of principal executive offices) (Zip Code)

(559) 782-4900

(Registrant's telephone number, including area code)

Not Applicable

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

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 requirements for the past 90 days.

Yes R 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes R No £

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer £	Accelerated filer R
Non-accelerated filer £ (Do not check if a smaller reporting company)	Smaller Reporting Company ¨

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

Yes £ No R

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, 14,121,139 shares outstanding as of April 30, 2014

FORM 10-Q

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PART I - FINANCIAL INFORMATION

Item 1 – Financial Statements

SIERRA BANCORP

CONSOLIDATED BALANCE SHEETS

(dollars in thousands)

	March 31, 2014 (unaudited)	December 31, 2013 (audited)
ASSETS		
Cash and due from banks	$ 45,379	$ 51,342
Interest-bearing deposits in banks	26,785	26,664
Total cash & cash equivalents	72,164	78,006
Investment securities available for sale	444,797	425,044
Loans held for sale	-	105
Loans and leases:		
Gross loans and leases	837,761	803,242
Allowance for loan and lease losses	(11,491)	(11,677)
Deferred loan and lease fees, net	1,254	1,522
Net loans and leases	827,524	793,087
Premises and equipment, net	21,153	20,393
Foreclosed assets	7,237	8,185
Goodwill	5,544	5,544
Other assets	79,902	79,885
TOTAL ASSETS	$ 1,458,321	$ 1,410,249
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Non-interest bearing	$ 354,455	$ 365,997
Interest bearing	865,723	808,182
Total deposits	1,220,178	1,174,179
Federal funds purchased and repurchase agreements	5,527	5,974
Short-term borrowings	-	-
Long-term borrowings	-	-
Junior subordinated debentures	30,928	30,928
Other liabilities	17,519	17,494
TOTAL LIABILITIES	1,274,152	1,228,575
SHAREHOLDERS' EQUITY		
Common stock, no par value; 24,000,000 shares authorized; 14,179,439 and 14,217,199 shares issued and outstanding at March 31, 2014 and December 31, 2013, respectively	65,886	65,780
Additional paid in capital	2,574	2,648

Retained earnings	114,420	112,817
Accumulated other comprehensive (loss) income	1,289	429
TOTAL SHAREHOLDERS' EQUITY	184,169	181,674
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 1,458,321	$ 1,410,249

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

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SIERRA BANCORP

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share data, unaudited)

	For the Quarter Ended March 31, 2014	For the Quarter Ended March 31, 2013
Interest income:		
Interest and fees on loans	$ 10,351	$ 10,912
Interest on investment securities:		
Taxable	1,825	1,162
Tax-exempt	741	619
Interest on federal funds sold and interest-bearing deposits	35	28
Total interest income	12,952	12,721
Interest expense:		
Interest on deposits	558	660
Interest on short-term borrowings	5	4
Interest on long-term borrowings	-	33
Interest on mandatorily redeemable trust preferred securities	174	177
Total interest expense	737	874
Net Interest Income	12,215	11,847
Provision for loan losses	150	1,600
Net Interest Income after provision for loan losses	12,065	10,247
Non-interest income:		
Service charges on deposit accounts	1,886	2,072
Gains on investment securities available-for-sale	104	6
Other income, net	1,717	2,032
Total non-interest income	3,707	4,110
Non-interest expense:		
Salaries and employee benefits	5,985	5,920
Occupancy expense	1,505	1,551
Other	3,239	4,348
Total non-interest expenses	10,729	11,819
Income before income taxes	5,043	2,538
Provision for income taxes	1,244	204

Net Income	$ 3,799	$ 2,334
PER SHARE DATA		
Book value	$ 12.99	$ 12.43
Cash dividends	$ 0.08	$ 0.06
Earnings per share basic	$ 0.27	$ 0.17
Earnings per share diluted	$ 0.26	$ 0.16
Average shares outstanding, basic	14,228,040	14,113,502
Average shares outstanding, diluted	14,373,196	14,194,223
Total shareholder equity (in thousands)	$ 184,169	175,542
Shares outstanding	14,179,439	14,119,679
Dividends paid	$ 1,137,965	$ 846,665

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

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SIERRA BANCORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in thousands, unaudited)

	For the Quarter Ended March 31, 2014	For the Quarter Ended March 31, 2013
Net Income	$ 3,799	$ 2,334
Other comprehensive income, before tax:		
Unrealized gains (losses) on securities:		
Unrealized holding gains (losses) arising during period	1,566	(85)
Less: reclassification adjustment for gains [1] included in net income	(104)	(6)
Other comprehensive income (loss), before tax	1,462	(91)
Income tax (expense) benefit related to items of other comprehensive income (loss), net of tax	(602)	37
Other comprehensive income (loss)	860	(54)
Comprehensive income	$ 4,659	$ 2,280

[1] Amounts are included in net gains on investment securities available-for-sale on the Consolidated Statements of Income in non-interest revenue. Income tax expense associated with the reclassification adjustment for the quarter ended March 31, 2014 and 2013 was $43 thousand and $3 thousand, respectively.

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

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SIERRA BANCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands, unaudited)

	For the Quarter Ended March 31, 2014			2013		
Cash flows from operating activities:						
Net income	$	3,799		$	2,334	
Adjustments to reconcile net income to net cash provided by operating activities:						
Gain on sales of securities		(104	)		(6	)
Gain on sales of loans		(3	)		(36	)
(Gain) loss on sale on foreclosed assets		(350	)		488	
Writedowns on foreclosed assets		84			87	
Share-based compensation expense		12			93	
Provision for loan losses		150			1,600	
Depreciation		506			590	
Net amortization on securities premiums and discounts		1,614			2,096	
(Increase) decrease in unearned net loan fees		(268	)		29	
Increase in cash surrender value of life insurance policies		(325	)		(593	)
Proceeds from sales of loans portfolio		108			1,257	
Increase in loans held-for-sale		-			(1,800	)
(Increase) decrease in interest receivable		(445	)		1,057	

and other assets		
Increase (decrease) in other liabilities	25	(1,295)
Deferred income tax provision	65	4
Excess tax benefit from equity based compensation	(86)	(34)
Net cash provided by operating activities	4,782	5,871
Cash flows from investing activities:		
Maturities of securities available for sale	450	140
Proceeds from sales/calls of securities available for sale	4,215	977
Purchases of securities available for sale	(41,899)	(47,006)
Principal pay downs on securities available for sale	17,433	25,141
Net (increase) decrease in loans receivable, net	(34,444)	49,928
Purchases of premises and equipment, net	(1,266)	(94)
Proceeds from sales of foreclosed assets	1,339	3,725
Net cash (used in) provided by investing activities	(54,172)	32,811
Cash flows from financing activities:		
Increase (decrease) in deposits	45,999	(18,100)
Decrease in borrowed funds	-	(35,050)
(Decrease) increase in repurchase agreements	(447)	1,254
Cash dividends paid	(1,138)	(847)
Repurchases of common stock	(1,492)	-

Stock options exercised		540			158	
Excess tax benefit from equity based compensation		86			34	
Net cash provided by (used in) financing activities		43,548			(52,551	)
Decrease in cash and due from banks		(5,842	)		(13,869	)
Cash and cash equivalents						
Beginning of period		78,006			61,818	
End of period	$	72,164		$	47,949	

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

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Sierra Bancorp

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2014

Note 1 – The Business of Sierra Bancorp

Sierra Bancorp (the “Company”) is a California corporation headquartered in Porterville, California, and is a registered bank holding company under federal banking laws. The Company was formed to serve as the holding company for Bank of the Sierra (the “Bank”), and has been the Bank’s sole shareholder since August 2001. The Company exists primarily for the purpose of holding the stock of the Bank and of such other subsidiaries it may acquire or establish. At the present time, the Company’s only other subsidiaries are Sierra Statutory Trust II and Sierra Capital Trust III, which were formed in March 2004 and June 2006, respectively, solely to facilitate the issuance of capital trust pass-through securities (TRUPS). Pursuant to the Financial Accounting Standards Board’s (FASB’s) standard on the consolidation of variable interest entities, these trusts are not reflected on a consolidated basis in the Company’s financial statements. References herein to the “Company” include Sierra Bancorp and its consolidated subsidiary, the Bank, unless the context indicates otherwise.

The Bank is a California state-chartered bank headquartered in Porterville, California, that offers a full range of retail and commercial banking services primarily to communities in the central and southern regions of the San Joaquin Valley. Our branch footprint stretches from Fresno on the north to Bakersfield on the south, and on the southern end extends east through the Tehachapi plateau and into the northwestern tip of the Mojave Desert. The Bank was incorporated in September 1977 and opened for business in January 1978, and in the ensuing years has grown to be the largest independent bank headquartered in the South San Joaquin Valley. Our growth has primarily been organic, but includes the acquisition of Sierra National Bank in 2000. We currently operate 25 full service branch offices throughout our geographic footprint, as well as an internet branch which provides the ability to open deposit accounts online. The Bank’s most recent branching activity includes the relocation of our Clovis branch to a larger facility in a more convenient location in the third quarter of 2012. In addition to our full-service branches, the Bank has a real estate industries group, an agricultural credit division, an SBA lending unit, and offsite ATMs at six different non-branch locations. The Bank’s deposit accounts are insured by the Federal Deposit Insurance Corporation (FDIC) up to maximum insurable amounts.

Note 2 – Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in a condensed format, and therefore do not include all of the information and footnotes required by US generally accepted accounting principles (GAAP) for complete financial statements. The information furnished in these interim statements reflects all adjustments that are, in the opinion of management, necessary for a fair statement of the results for such period. Such adjustments are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q. In preparing the accompanying consolidated financial statements, management has taken subsequent events into consideration and recognized them where appropriate. The results of operations in the interim statements are not necessarily indicative of the results that may be expected for any other quarter, or for the full year. Certain amounts reported for 2013 have been reclassified to be consistent with the reporting for 2014. The interim financial information should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the Securities and Exchange Commission.

Note 3 – Current Accounting Developments

In January 2014, the FASB issued Accounting Standards Update (ASU) 2014-01, *Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects*, to provide additional flexibility with regard to accounting for investments in qualified affordable housing projects. ASU 2014-01 modifies the conditions that must be met to present the pretax impact and related tax benefits of such investments as a component of income taxes ("net" within income tax expense), to enable more investors to elect to use a "net" presentation for those investments. Investors that do not qualify for "net" presentation under the new guidance will continue to account for such investments under the equity method or cost method, which results in losses recognized in pretax income and tax benefits recognized in income taxes ("gross" presentation of investment results). For investments that qualify for the "net" presentation of investment performance, ASU 2014-01 introduces a "proportional amortization method" that can be elected to amortize the investment basis. If elected, the method is required for all eligible investments in qualified affordable housing projects. ASU 2014-01 also requires enhanced recurring disclosures for all investments in qualified affordable housing projects, regardless of the accounting method used for those investments. It is effective for interim and annual periods beginning after December 15, 2014, and early adoption is permitted. The Company currently expects to adopt ASU 2014-01 as of the first quarter of 2015. We will likely continue to account for our low-income housing tax credit investments using the equity method subsequent to our adoption of ASU 2014-01 and thus do not expect any impact on our income statement or balance sheet, but our disclosures with regard to low-income housing tax credit investments will be updated to reflect the new requirements.

In January 2014, the FASB issued ASU 2014-04, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*, to resolve diversity in practice with respect to a creditor's reclassification of a collateralized consumer mortgage loan to other real estate owned (OREO). Current US GAAP requires a loan to be reclassified to OREO upon a troubled debt restructuring that is "in substance a repossession or foreclosure", where the creditor receives "physical possession" of the debtor's assets regardless of whether formal foreclosure proceedings take place. The terms "in substance a repossession or foreclosure" and "physical possession" are not defined in US GAAP; therefore, questions have arisen about when a creditor should reclassify a collateralized mortgage loan to OREO. ASU 2014-04 requires a creditor to reclassify a collateralized consumer mortgage loan to real estate property upon obtaining legal title to the real estate collateral, or when the borrower voluntarily conveys 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. ASU 2014-04 is effective for public business entities for interim and annual periods beginning after December 15, 2014. It will be adopted by the Company for the first quarter of 2015, and we do not expect any impact upon our financial statements or operations upon adoption.

Note 4 – Supplemental Disclosure of Cash Flow Information

During the three months ended March 31, 2014 and 2013, cash paid for interest due on interest-bearing liabilities was $777,000 and $993,000, respectively. There was no cash paid for income taxes during the three months ended March 31, 2014 and 2013. Assets totaling $125,000 and $293,000 were acquired in settlement of loans for the three months ended March 31, 2014 and March 31, 2013, respectively. We received $1.339 million in cash from the sale of foreclosed assets during the first three months of 2014 relative to $3.333 million during the first three months of 2013, which represents sales proceeds less loans extended to finance such sales.

Note 5 – Share Based Compensation

The 2007 Stock Incentive Plan (the "2007 Plan") was adopted by the Company in 2007. Our 1998 Stock Option Plan (the "1998 Plan") was concurrently terminated, although options to purchase 127,950 shares that were granted under the 1998 Plan were still outstanding as of March 31, 2014 and remain unaffected by that plan's termination. The 2007 Plan provides for the issuance of both "incentive" and "nonqualified" stock options to officers and employees, and of "nonqualified" stock options to non-employee directors of the Company. The 2007 Plan also provides for the potential issuance of restricted stock awards to these same classes of eligible participants, on such terms and conditions as are established at the discretion of the Board of Directors or the Compensation Committee. The total number of shares of the Company's authorized but unissued stock reserved for issuance pursuant to awards under the 2007 Plan was initially 1,500,000 shares, although the number remaining available for grant as of March 31, 2014 was 810,800. The dilutive impact of stock options outstanding is discussed below in Note 6, Earnings per Share. No restricted stock awards have been issued by the Company.

Pursuant to FASB's standards on stock compensation, the value of each option granted is reflected in our income statement as employee compensation or directors' expense by amortizing the value over the vesting period of such option or by expensing it as of the grant date for immediately vested options. The Company is utilizing the Black-Scholes model to value stock options, and the "multiple option" approach is used to allocate the resulting valuation to actual expense. Under the multiple option approach an employee's options for each vesting period are separately valued and amortized, which appears to be the preferred method for option grants with graded vesting. A pre-tax charge of $12,000 was reflected in the Company's income statement during the first quarter of 2014 and $93,000 was charged during the first quarter of 2013, as expense related to stock options.

Note 6 – Earnings per Share

The computation of earnings per share, as presented in the Consolidated Statements of Income, is based on the weighted average number of shares outstanding during each period. There were 14,228,040 weighted average shares outstanding during the first quarter of 2014, and 14,113,502 during the first quarter of 2013.

Diluted earnings per share include the effect of the potential issuance of common shares, which for the Company is limited to shares that would be issued on the exercise of "in-the-money" stock options. The dilutive effect of options outstanding was calculated using the treasury stock method, excluding anti-dilutive shares and adjusting for unamortized expense and windfall tax benefits. For the first quarter of 2014 the dilutive effect of options outstanding calculated under the treasury stock method totaled 145,156, which was added to basic weighted average shares outstanding for purposes of calculating diluted earnings per share. Likewise, for the first quarter of 2013 shares totaling 80,721 were added to basic weighted average shares outstanding in order to calculate diluted earnings per share.

Note 7 – Comprehensive Income

As presented in the Consolidated Statements of Comprehensive Income, comprehensive income includes net income and other comprehensive income. The Company's only source of other comprehensive income is unrealized gains and losses on available-for-sale investment securities. Gains or losses on investment securities that were realized and included in net income of the current period, which had previously been included in other comprehensive income as unrealized holding gains or losses in the period in which they arose, are considered to be reclassification adjustments that are excluded from other comprehensive income in the current period.

Note 8 – Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business, in order to meet the financing needs of its customers. Those financial instruments consist of unused commitments to extend credit and standby letters of credit. They involve, to varying degrees, elements of risk in excess of the amount recognized in the balance sheet. The Company's exposure to credit loss in the event of nonperformance by counterparties for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and issuing letters of credit as it does for originating loans included on the balance sheet. The following financial instruments represent off-balance-sheet credit risk (dollars in thousands):

	March 31, 2014	December 31, 2013
Commitments to extend credit	$ 425,048	$ 420,707
Standby letters of credit	$ 8,724	$ 8,703
Commercial letters of credit	$ 8,069	$ 8,070

Commitments to extend credit consist primarily of the unused or unfunded portions of the following: home equity lines of credit; commercial real estate construction loans, where disbursements are made over the course of construction; commercial revolving lines of credit; mortgage warehouse lines of credit; unsecured personal lines of credit; and formalized (disclosed) deposit account overdraft lines. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many commitments are expected to expire without being drawn upon, the unused portions of committed amounts do not necessarily represent future cash requirements.

Standby letters of credit are generally unsecured and are issued by the Company to guarantee the performance of a customer to a third party, while commercial letters of credit represent the Company's commitment to pay a third party on behalf of a customer upon fulfillment of contractual requirements. The credit risk involved in issuing letters of credit is essentially the same as the risk involved in extending loans to customers.

The Company is also utilizing a $78 million letter of credit issued by the Federal Home Loan Bank on the Company's behalf as security for certain deposits. The letter of credit is backed by specific loans which are pledged to the Federal Home Loan Bank by the Company.

Note 9 – Fair Value Disclosures and Reporting, the Fair Value Option and Fair Value Measurements

FASB's standards on financial instruments, and on fair value measurements and disclosures, require all entities to disclose in their financial statement footnotes the estimated fair values of financial instruments for which it is practicable to estimate fair values. In addition to disclosure requirements, FASB's standard on investments requires that our debt securities, which are classified as available for sale, and our equity securities that have readily determinable fair values, be measured and reported at fair value in our statement of financial position. Certain impaired loans are also reported at fair value, as explained in greater detail below, and foreclosed assets are carried at the lower of cost or fair value. FASB's standard on financial instruments permits companies to report certain other financial assets and liabilities at fair value, but we have not elected the fair value option for any additional financial assets or liabilities.

Fair value measurements and disclosure standards also establish a framework for measuring fair values. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants on the measurement date. Further, the standards establish a fair value hierarchy that encourages an entity to maximize the use of observable inputs and limit the use of unobservable inputs when measuring fair values. The standards describe three levels of inputs that may be used to measure fair values:

- Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

- Level 2: Significant observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

- Level 3: Significant unobservable inputs that reflect a company's own assumptions about the factors that market participants would likely consider in pricing an asset or liability.

Fair value estimates are made at a specific point in time based on relevant market data and information about the financial instruments. The estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to realized gains and losses could have a significant effect on fair value estimates but have not been considered in any estimates. Because no market exists for a significant portion of the Company's financial instruments, fair value disclosures are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. The estimates are subjective and involve uncertainties and matters of significant judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the fair values presented. The following methods and assumptions were used by the Company to estimate the fair value of its financial instruments disclosed at March 31, 2014 and December 31, 2013:

- Cash and cash equivalents and fed funds sold: The carrying amount is estimated to be fair value.

- Investment securities: Fair values are determined by obtaining quoted prices on nationally recognized securities exchanges or by matrix pricing, which is a mathematical technique used widely in the industry to value debt securities by relying on their relationship to other benchmark quoted securities when quoted prices for specific securities are not readily available.

- Loans and leases: For variable-rate loans and leases that re-price frequently with no significant change in credit risk or interest rate spread, fair values are based on carrying values. Fair values for other loans and leases are estimated by discounting projected cash flows at interest rates being offered at each reporting date for loans and leases with similar terms, to borrowers of comparable creditworthiness. The carrying amount of accrued interest receivable approximates its fair value.

- Loans held for sale: Since loans designated by the Company as available-for-sale are typically sold shortly after making the decision to sell them, realized gains or losses are usually recognized within the same period and fluctuations in fair values are not relevant for reporting purposes. If available-for-sale loans are on our books for an extended period of time, the fair value of those loans is determined using quoted secondary-market prices.

- Collateral-dependent impaired loans: Impaired loans carried at fair value are those for which it is probable that the bank will be unable to collect all amounts due according to the contractual terms of the original loan agreement, and the carrying value has been written down to the fair value of the loan. The carrying value is equivalent to the fair value of the collateral, net of expected disposition costs where applicable, for collateral-dependent loans.

- Cash surrender value of life insurance policies: Fair values are based on net cash surrender values at each reporting date.

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- Investments in, and capital commitments to, limited partnerships: The fair values of our investments in WNC Institutional Tax Credit Fund Limited Partnerships and any other limited partnerships are estimated using quarterly indications of value provided by the general partner. The fair values of undisbursed capital commitments are assumed to be the same as their book values.

- Other investments: Certain investments for which no secondary market exists are carried at cost unless an impairment analysis indicates the need for adjustments, and the carrying amount for those investments approximates their estimated fair value.

- Deposits: Fair values for non-maturity deposits are equal to the amount payable on demand at the reporting date, which is the carrying amount. Fair values for fixed-rate certificates of deposit are estimated using a cash flow analysis, discounted at interest rates being offered at each reporting date by the Bank for certificates with similar remaining maturities. The carrying amount of accrued interest payable approximates its fair value.

- Short-term borrowings: The carrying amounts approximate fair values for federal funds purchased, overnight FHLB advances, borrowings under repurchase agreements, and other short-term borrowings maturing within ninety days of the reporting dates. Fair values of other short-term borrowings are estimated by discounting projected cash flows at the Company's current incremental borrowing rates for similar types of borrowing arrangements.

- Long-term borrowings: Fair values are estimated using projected cash flows discounted at the Company's current incremental borrowing rates for similar types of borrowing arrangements.

- Subordinated debentures: Fair values are determined based on the current market value for like instruments of a similar maturity and structure.

- Commitments to extend credit and letters of credit: If funded, the carrying amounts for currently unused commitments would approximate fair values for the newly created financial assets at the funding date. However, because of the high degree of uncertainty with regard to whether or not those commitments will ultimately be funded, fair values for loan commitments and letters of credit in their current undisbursed state cannot reasonably be estimated, and only notional values are disclosed in the table below.

Estimated fair values for the Company's financial instruments are as follows, as of the dates noted:

Fair Value of Financial Instruments

(dollars in thousands, unaudited)	March 31, 2014				
		Estimated Fair Value			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial assets:					
Cash and cash equivalents	$72,164	$72,164	$ -	$ -	$72,164
Investment securities available for sale	444,797	2,595	442,202	-	444,797
Loans and leases, net	806,226	-	824,197	-	824,197
Collateral dependent impaired loans	21,298	-	21,298	-	21,298
Loans held-for-sale	-	-	-	-	-
Cash surrender value of life insurance policies	39,749	-	39,749	-	39,749
Other investments	5,932	-	5,932	-	5,932
Investment in limited partnership	8,929	-	8,929	-	8,929
Accrued interest receivable	5,067	-	5,067	-	5,067
Financial liabilities:					
Deposits:					
Noninterest-bearing	$354,455	$354,455	$ -	$ -	$354,455
Interest-bearing	865,723	-	865,994	-	865,994
Fed funds purchased and repurchase agreements	5,527	-	5,527	-	5,527
Short-term borrowings	-	-	-	-	-
Long-term borrowings	-	-	-	-	-
Subordinated debentures	30,928	-	11,190	-	11,190
Limited partnership capital commitment	914	-	914	-	914
Accrued interest payable	146	-	146	-	146

	Notional Amount
Off-balance-sheet financial instruments:	
Commitments to extend credit	$425,048
Standby letters of credit	8,724
Commercial lines of credit	8,069

	December 31, 2013			
		Estimated Fair Value		
		Quoted Prices in Active Markets for	Significant Observable	Significant Unobservable

	Carrying Amount	Identical Assets (Level 1)	Inputs (Level 2)	Inputs (Level 3)	Total
Financial assets:					
Cash and cash equivalents	$78,006	$78,006	$ -	$ -	$78,006
Investment securities available for sale	425,044	2,456	422,588	-	425,044
Loans and leases, net	778,382	-	797,383	-	797,383
Collateral dependent impaired loans	14,705	-	14,705	-	14,705
Loans held-for-sale	105	105	-	-	105
Cash surrender value of life insurance policies	39,424	-	39,424	-	39,424
Other Investments	5,932	-	5,932	-	5,932
Investment in limited partnership	9,204	-	9,204	-	9,204
Accrued interest receivable	4,990	-	4,990	-	4,990
Financial liabilities:					
Deposits:					
Noninterest-bearing	$365,997	$365,997	$ -	$ -	$365,997
Interest-bearing	808,182	-	808,182	-	808,182
Fed funds purchased and repurchase agreements	5,974	-	5,974	-	5,974
Short-term borrowings	-	-	-	-	-
Long-term borrowings	-	-	-	-	-
Subordinated debentures	30,928	-	11,175	-	11,175
Limited partnership capital commitment	962	-	962	-	962
Accrued interest payable	186	-	186	-	186

	Notional Amount
Off-balance-sheet financial instruments:	
Commitments to extend credit	$420,707
Standby letters of credit	8,703
Commercial lines of credit	8,070

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For financial asset categories that were actually reported at fair value at March 31, 2014 and December 31, 2013, the Company used the following methods and significant assumptions:

- Investment securities: Fair values are determined by obtaining quoted prices on nationally recognized securities exchanges or by matrix pricing, which is a mathematical technique used widely in the industry to value debt securities by relying on their relationship to other benchmark quoted securities.

- Collateral-dependent impaired loans: Impaired loans carried at fair value are those for which it is probable that the bank will be unable to collect all amounts due (including both principal and interest) according to the contractual terms of the original loan agreement, and the carrying value has been written down to the fair value of the loan. The carrying value is equivalent to the fair value of the collateral based on current appraisals, net of expected disposition costs where applicable, for collateral-dependent loans.

- Foreclosed assets: Repossessed real estate (OREO) and other foreclosed assets are carried at the lower of cost or fair value. Fair value is the appraised value less expected selling costs for OREO and some other assets such as mobile homes, and for all other assets fair value is represented by the estimated sales proceeds as determined using reasonably available sources. Foreclosed assets for which appraisals can be feasibly obtained are periodically measured for impairment using updated appraisals. Fair values for other foreclosed assets are adjusted as necessary, subsequent to a periodic re-evaluation of expected cash flows and the timing of resolution. If impairment is determined to exist, the book value of a foreclosed asset is immediately written down to its estimated impaired value through the income statement, thus the carrying amount is equal to the fair value and there is no valuation allowance.

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Assets reported at fair value on a recurring basis are summarized below:

Fair Value Measurements - Recurring

(dollars in thousands, unaudited)

	Fair Value Measurements at March 31, 2014, Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Investment securities				
U.S. Government agencies	$ -	$ 4,781	$ -	$ 4,781
Obligations of states and political subdivisions	-	95,008	-	95,008
U.S. Government agencies collateralized by mortgage obligations	-	342,413	-	342,413
Other securities	2,595	-	-	2,595
Total available-for-sale securities	$ 2,595	$ 442,202	$ -	$ 444,797

	Fair Value Measurements at December 31, 2013, Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Investment securities				
U.S. Government agencies	$ -	$ 5,304	$ -	$ 5,304
Obligations of states and political subdivisions	-	320,721	-	320,721
U.S. Government agencies collateralized by mortgage obligations	-	96,563	-	96,563
Other securities	2,456	-	-	2,456
Total available-for-sale securities	$ 2,456	$ 422,588	$ -	$ 425,044

Assets reported at fair value on a nonrecurring basis are summarized below:

Fair Value Measurements - Nonrecurring

(dollars in thousands, unaudited)

	Fair Value Measurements at March 31, 2014, Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Collateral dependent impaired loans	$ -	$ 21,298	$ -	$ 21,298
Foreclosed assets	$ -	$ 7,237	$ -	$ 7,237

	Fair Value Measurements at December 31, 2013, Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Collateral dependent impaired loans	$ -	$ 14,705	$ -	$ 14,705
Foreclosed assets	$ -	$ 8,185	$ -	$ 8,185

The table above includes collateral-dependent impaired loan balances for which a specific reserve has been established or on which a write-down has been taken. Information on the Company’s total impaired loan balances, and specific loss reserves associated with those balances, is included in Note 11 below, and in Management’s Discussion and Analysis of Financial Condition and Results of Operation in the “Nonperforming Assets” and “Allowance for Loan and Lease Losses” sections.

The unobservable inputs are based on management’s best estimates of appropriate discounts in arriving at fair market value. Increases or decreases in any of those inputs could result in a significantly lower or higher fair value measurement. For example, a change in either direction of actual loss rates would have a directionally opposite change in the calculation of the fair value of unsecured impaired loans.

Note 10 – Investments

Although the Company currently has the intent and the ability to hold the securities in its investment portfolio to maturity, the securities are all marketable and are classified as "available for sale" to allow maximum flexibility with regard to interest rate risk and liquidity management. Pursuant to FASB's guidance on accounting for debt and equity securities, available for sale securities are carried on the Company's financial statements at their estimated fair market values, with monthly tax-effected "mark-to-market" adjustments made vis-à-vis accumulated other comprehensive income in shareholders' equity.

The table below summarizes the Company's available-for-sale investment securities by type, as of the dates indicated:

Amortized Cost And Estimated Fair Value

The amortized cost and estimated fair value of investment securities available-for-sale are as follows

(dollars in thousands, unaudited):

	March 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
US Government agencies	$4,874	$ 4	$ (97)	$ 4,781
Mortgage-backed securities	341,917	3,173	(2,677)	342,413
State and poltical subdivisions	94,479	2,083	(1,554)	95,008
Equity securities	1,336	1,259	-	2,595
Total investment securities	$442,606	$ 6,519	$ (4,328)	$ 444,797

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
US Government agencies	$5,395	$ 18	$ (109)	$ 5,304
Mortgage-backed securities	320,223	3,269	(2,771)	320,721
State and political subdivisons	97,361	1,723	(2,521)	96,563
Equity securities	1,336	1,120	-	2,456
Total investment securities	$424,315	$ 6,130	$ (5,401)	$ 425,044

At March 31, 2014 and December 31, 2013, the Company had 198 securities and 89 securities, respectively, with unrealized losses. Management has evaluated those securities as of the respective dates, and does not believe that any of the associated unrealized losses are other than temporary. Information pertaining to our investment securities with unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous loss position, is disclosed in the table below.

Investment Portfolio - Unrealized Losses

(dollars in thousands, unaudited)	March 31, 2014			
	Less than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
US Government agencies	$(75)	$ 1,929	$(22)	$ 1,509
Mortgage-backed securities	(1,004)	38,936	(1,673)	137,071
State and political subdivisions	(695)	12,919	(859)	27,351
Other securities	-	-	-	-
Total investment securities	$(1,774)	$ 53,784	$(2,554)	$ 165,931

	December 31, 2013			
	Less than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
US Government agencies	$(92)	$ 1,913	$(17)	$ 1,920
Mortgage-backed securities	(642)	21,747	(2,129)	124,317
State and political subdivisions	(461)	6,799	(2,060)	38,083
Other securities	-	-	-	-
Total investment securities	$(1,195)	$ 30,459	$(4,206)	$ 164,320

Note 11 – Credit Quality and Nonperforming Assets

Credit Quality Classifications

The Company monitors the credit quality of loans on a continuous basis using the regulatory and accounting classifications of pass, special mention, substandard and impaired to characterize the associated credit risk. Balances classified as “loss” are immediately charged off. The Company conforms to the following definitions for risk classifications utilized:

- Pass: Larger non-homogeneous loans not meeting the risk rating definitions below, and smaller homogeneous loans that are not assessed on an individual basis.

- Special mention: Loans which have potential issues that deserve the close attention of management. If left uncorrected, those potential weaknesses could eventually diminish the prospects for full repayment of principal and interest according to the contractual terms of the loan agreement, or could result in deterioration of the Company's credit position at some future date.

- Substandard: Loans that have at least one clear and well-defined weakness which could jeopardize the ultimate recoverability of all principal and interest, such as a borrower displaying a highly leveraged position, unfavorable financial operating results and/or trends, uncertain repayment sources or a deteriorated financial condition.

- Impaired: A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans include all nonperforming loans, restructured troubled debt (TDRs), and certain other loans that are still being maintained on accrual status. A TDR may be nonperforming or performing, depending on its accrual status and the demonstrated ability of the borrower to comply with restructured terms (see "Troubled Debt Restructurings" section below for additional information on TDRs).

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Credit quality classifications for the Company's loan balances were as follows, as of the dates indicated:

Credit Quality Classifications
(dollars in thousands, unaudited)

	March 31, 2014				
	Pass	Special Mention	Substandard	Impaired	Total
Real Estate:					
1-4 family residential construction	$2,458	$-	$ 242	$59	$2,759
Other construction/land	22,407	175	128	5,690	28,400
1-4 family - closed end	96,538	1,033	619	17,461	115,651
Equity lines	48,668	413	1,162	1,849	52,092
Multi-family residential	6,127	425	-	-	6,552
Commercial real estate - owner occupied	173,219	18,006	3,791	9,468	204,484
Commercial real estate - non-owner occupied	90,816	3,604	209	13,374	108,003
Farmland	104,547	1,852	809	66	107,274
Total real estate	544,780	25,508	6,960	47,967	625,215
Agricultural	23,918	1,781	-	327	26,026
Commercial and Iindustrial	158,085	2,388	526	3,541	164,540
Consumer loans	18,055	430	186	3,309	21,980
Total gross loans and leases	$744,838	$30,107	$ 7,672	$55,144	$837,761

	December 31, 2013				
	Pass	Special Mention	Substandard	Impaired	Total
Real Estate:					
1-4 family residential construction	$1,720	$-	$ -	$-	$1,720
Other construction/land	18,243	334	203	6,751	25,531
1-4 family - closed end	67,051	1,305	770	17,898	87,024
Equity lines	51,019	254	1,429	1,021	53,723
Multi-family residential	8,059	426	-	-	8,485
Commercial real estate - owner occupied	158,155	17,033	3,261	7,563	186,012
Commercial real estate - non-owner occupied	89,475	3,630	240	13,495	106,840
Farmland	105,623	1,780	819	282	108,504
Total real estate	499,345	24,762	6,722	47,010	577,839
Agricultural	24,178	532	-	470	25,180
Commercial and industrial	166,649	3,358	1,236	5,444	176,687
Consumer loans	19,387	478	208	3,463	23,536
Total gross loans and leases	$709,559	$29,130	$ 8,166	$56,387	$803,242

Past Due and Nonperforming Assets

Nonperforming assets are comprised of loans for which the Company is no longer accruing interest, and foreclosed assets, including mobile homes and other real estate owned (OREO). OREO consists of properties acquired by foreclosure or similar means, which the Company is offering or will offer for sale. Nonperforming loans and leases result when reasonable doubt surfaces with regard to the ability of the Company to collect all principal and interest. At that point, we stop accruing interest on the loan or lease in question and reverse any previously-recognized interest to the extent that it is uncollected or associated with interest-reserve loans. Any asset for which principal or interest has been in default for 90 days or more is also placed on non-accrual status even if interest is still being received, unless the asset is both well secured and in the process of collection. An aging of the Company’s loan balances is presented in the following tables, by number of days past due as of the indicated dates:

Loan Portfolio Aging

(dollars in thousands, unaudited)

	March 31, 2014						
	30-59 Days Past Due	60-89 Days Past Due	90 Days Or More Past Due[2]	Total Past Due	Current	Total Financing Receivables	Non-Accrual Loans[1]
Real Estate:							
1-4 family residential construction	$ -	$ -	$ -	$ -	$ 2,759	$ 2,759	$ 59
Other construction/land	3,161	-	88	3,249	25,151	28,400	4,479
1-4 family - closed end	3,892	204	47	4,143	111,508	115,651	12,765
Equity lines	267	150	817	1,234	50,858	52,092	1,607
Multi-family residential	-	-	-	-	6,552	6,552	-
Commercial real estate - owner occupied	1,352	1,049	2,514	4,915	199,569	204,484	6,629
Commercial real estate - non-owner occupied	-	-	7,012	7,012	100,991	108,003	7,989
Farmland	353	-	-	353	106,921	107,274	66
Total real estate	9,025	1,403	10,478	20,906	604,309	625,215	33,594
Agricultural	1,295	-	327	1,622	24,404	26,026	327
Commercial and industrial	767	203	441	1,411	163,129	164,540	1,281
Consumer loans	180	88	96	364	21,616	21,980	997
Total gross loans and leases	$ 11,267	$ 1,694	$ 11,342	$ 24,303	$ 813,458	$ 837,761	$ 36,199

[1] Included in total financing receivables

[2] As of March 31, 2014 there were no loans over 90 days past due and still acrruing.

	December 31, 2013						
	30-59 Days Past Due	60-89 Days Past Due	90 Days Or More Past Due[2]	Total Past Due	Current	Total Financing Receivables	Non-Accrual Loans[1]
Real Estate:							
1-4 family residential construction	$ -	$ -	$ -	$ -	$ 1,720	$ 1,720	$ -
Other construction/land	294	-	116	410	25,121	25,531	5,528
1-4 family - closed end	2,181	300	171	2,652	84,372	87,024	13,168

Equity lines	98	-	288	386	53,337	53,723	778
Multi-family residential	-	-	-	-	8,485	8,485	-
Commercial real estate - owner occupied	1,917	144	2,011	4,072	181,940	186,012	5,516
Commercial real estate - non-owner occupied	-	-	7,667	7,667	99,173	106,840	8,058
Farmland	331	-	-	331	108,173	108,504	282
Total real estate	4,821	444	10,253	15,518	562,321	577,839	33,330
Agricultural	892	327	125	1,344	23,836	25,180	470
Commercial and industrial	1,318	587	1,298	3,203	173,484	176,687	2,622
Consumer loans	181	-	-	181	23,355	23,536	992
Total gross loans and leases	$7,212	$ 1,358	$ 11,676	$ 20,246	$782,996	$ 803,242	$ 37,414

(1) Included in total financing receivables

(2) As of December 31, 2013 there were no loans over 90 days past due and still accruing.

Troubled Debt Restructurings

A loan that is modified for a borrower who is experiencing financial difficulty is classified as a troubled debt restructuring (TDR), if the modification constitutes a concession. At March 31, 2014, the Company had a total of $39.3 million in TDRs, including $24.1 million in TDRs that were on non-accrual status. Generally, a non-accrual loan that has been modified as a TDR remains on non-accrual status for a period of at least six months to demonstrate the borrower’s ability to comply with the modified terms. However, performance prior to the modification, or significant events that coincide with the modification, could result in a loan’s return to accrual status after a shorter performance period or even at the time of loan modification. TDRs may have the TDR designation removed in the calendar year following the restructuring, if the loan is in compliance with all modified terms and is yielding a market rate of interest. Regardless of the period of time that has elapsed, if the borrower’s ability to meet the revised payment schedule is uncertain then the loan will be kept on non-accrual status. Moreover, a TDR is generally considered to be in default when it appears that the customer will not likely be able to repay all principal and interest pursuant to the terms of the restructured agreement.

The Company may agree to different types of concessions when modifying a loan or lease. The tables below summarize TDRs which were modified during the noted periods, by type of concession:

Troubled Debt Restructurings, by Type of Loan Modification

(dollars in thousands, unaudited)

For the Quarter Ended March 31, 2014	Rate Modification	Term Modification	Interest Only Modification	Rate & Term Modification	Rate & Interest Only Modification	Term & Interest Only Modification	Rate, Term & Interest Only Modification	Total
Real estate:								
Other construction/land	$-	$ -	$ -	$ -	$ -	$ -	$ -	$-
1-4 family - closed-end	-	13	-	-	-	-	-	13
Equity lines	-	-	-	-	-	-	-	-
Commercial real estate - owner occupied	-	123	-	-	-	-	-	123
Commercial real estate - non-owner occupied	-	-	-	-	-	-	-	-
Total real estate loans	-	136	-	-	-	-	-	136
Commercial and industrial	-	110	-	4	-	-	-	114
Consumer loans	-	2	-	-	-	-	-	2
	$-	$ 248	$ -	$ 4	$ -	$ -	$ -	$252

For the Year Ended December 31, 2013	Rate Modification	Term Modification	Interest Only Modification	Rate & Term Modification	Rate & Interest Only Modification	Term & Interest Only Modification	Rate, Term & Interest Only Modification	Total
Real Estate:								
Other construction/land	$-	$ 416	$ -	$ -	$ -	$ -	$ -	$416
1-4 family - closed-end	-	3,338	-	238	-	-	102	3,678
Equity lines	-	-	40	-	-	-	-	40
Commercial real estate - owner occupied	-	-	-	557	-	-	-	557
Commercial real estate - non-owner occupied	-	-	-	-	-	-	-	-
Total real estate loans	-	3,754	40	795	-	-	102	4,691
Commercial and industrial	-	1,563	-	308	-	-	-	1,871
Consumer loans	-	469	-	-	-	-	92	561

$-	$ 5,786	$ 40	$ 1,103	$ -	$ -	$ 194	$7,123

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The following tables present, by class, additional details related to loans classified as TDRs during the referenced periods, including the recorded investment in the loan both before and after modification and balances that were modified during the period:

<u>Troubled Debt Restructurings</u>
(dollars in thousands, unaudited)

For the Three Months Ended March 31, 2014

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Reserve Difference[1]	Reserve
Real Estate:					
Other Construction/Land	-	$ -	$ -	$ -	$ -
1-4 family - closed-end	1	13	13	-	-
Equity Lines	-	-	-	-	-
Commercial RE- owner occupied	1	123	123	-	-
Commercial RE- non-owner occupied	-	-	-	-	-
Total Real Estate Loans		136	136	-	-
Commercial and Industrial	3	114	114	23	20
Consumer loans	1	2	2	-	-
		$ 252	$ 252	$ 23	$ 20

[1] This represents the change in the ALLL reserve for these credits measured as the difference between the specific post-modification impairment reserve and the pre-modification reserve calculated under our general allowance for loan loss methodology.

For the Three Months Ended March 31, 2013

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Reserve Difference[1]	Reserve
Real Estate:					
Other Construction/Land	1	$ 249	$ 247	$ 6	$ 4
1-4 family - closed-end	1	3,240	3,240	-	-
Equity Lines	-	-	-	-	-
Commercial RE- owner occupied	-	-	-	-	-

Commercial RE- non-owner occupied	-	-	-	-	-
Total Real Estate Loans		3,489	3,487	6	4
Commercial and Industrial	3	1,457	1,457	(38)	57
Consumer loans	-	263	263	31	39
		$ 5,209	$ 5,207	$ (1)	$ 100

(1) This represents the change in the ALLL reserve for these credits measured as the difference between the specific post-modification impairment reserve and the pre-modification reserve calculated under our general allowance for loan loss methodology.

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The tables below summarize TDRs that defaulted during the periods noted, and any charge-offs on those TDRs resulting from such default.

Troubled Debt Restructurings
(dollars in thousands, unaudited)

	Subsequent default three months ended March 31, 2014		
	Number of Loans	Recorded Investment	Charge-Offs
Real Estate:			
Other Construction/Land	-	$ -	$ -
1-4 family - closed-end	-	-	-
Equity Lines	-	-	-
Commercial real estate- owner occupied	-	-	-
Total Real Estate Loans		-	-
Commercial and Industrial	1	127	-
Consumer Loans	2	133	58
		$ 260	$ 58

	Subsequent default three months ended March 31, 2013		
	Number of Loans	Recorded Investment	Charge-Offs
Real Estate:			
Other Construction/Land	-	$ -	$ -
1-4 family - closed-end	-	-	-
Equity Lines	-	-	-
Commercial real estate- owner occupied	-	-	-
Total Real Estate Loans		-	-
Commercial and Industrial	2	173	96
Consumer Loans	1	2	2
		$ 175	$ 98

Note 12 – Allowance for Loan and Lease Losses

The Company’s allowance for loan and lease losses, a contra-asset, is established through a provision for loan and lease losses. The allowance is maintained at a level that is considered adequate to absorb probable losses on certain specifically identified loans, as well as probable incurred losses inherent in the remaining loan portfolio. Specifically identifiable and quantifiable losses are immediately charged off against the allowance; recoveries are generally recorded only when cash payments are received subsequent to the charge off. We employ a systematic methodology, consistent with FASB guidelines on loss contingencies and impaired loans, for determining the appropriate level of the allowance for loan and lease losses and adjusting it at least quarterly. Pursuant to that methodology, impaired loans and leases are individually analyzed and a criticized asset action plan is completed specifying the financial status of the borrower and, if applicable, the characteristics and condition of collateral and any associated liquidation plan. A specific loss allowance is created for each impaired loan, if necessary. The following tables disclose the unpaid principal balance, recorded investment (including accrued interest), average recorded investment, and interest income recognized for impaired loans on our books as of the dates indicated. Balances are shown by loan type, and are further broken out by those that required an allowance and those that did not, with the associated allowance disclosed for those that required such. Included in the valuation allowance for impaired loans shown in the tables below are specific reserves allocated to TDRs, totaling $3.184 million at March 31, 2014 and $3.321 million at December 31, 2013.

Impaired Loans	March 31, 2014				
(dollars in thousands, unaudited)	Unpaid Principal Balance[1]	Recorded Investment[2]	Related Allowance	Average Recorded Investment	Interest Income Recognized[3]
With an allowance recorded					
Real Estate:					
1-4 family residential construction	$-	$ -	$ -	$ -	$ -
Other construction/land	2,943	2,943	462	3,020	22
1-4 Family - closed-end	13,353	13,353	1,340	13,690	75
Equity lines	1,397	1,396	486	1,428	3
Commercial real estate- owner occupied	3,964	3,964	1,014	3,984	33
Commercial real estate- non-owner occupied	10,668	10,668	1,097	11,074	116
Farmland	-	-	-	-	-
Total real estate	32,325	32,324	4,399	33,196	249
Agriculture	-	-	-	-	-
Commercial and industrial	2,540	2,438	617	2,525	22
Consumer loans	3,257	3,247	224	3,355	41
	38,122	38,009	5,240	39,076	312
With no related allowance recorded					
Real estate:					
1-4 family residential construction	136	59	-	60	-
Other construction/land	3,013	2,747	-	2,869	-
1-4 family - closed-end	4,260	4,108	-	4,242	-
Equity lines	590	453	-	487	-
Commercial real estate- owner occupied	7,271	5,504	-	5,752	-
Commercial real estate- non-owner occupied	3,011	2,706	-	2,799	27
Farmland	66	66	-	69	-
Total real estate	18,347	15,643	-	16,278	27
Agriculture	327	327	-	334	-
Commercial and industrial	1,143	1,103	-	1,138	11
Consumer loans	331	62	-	140	-
	20,148	17,135	-	17,890	38
Total	$58,270	$ 55,144	$ 5,240	$ 56,966	$ 350

[1]Contractual principal balance due from customer.

[2]Principal balance on Company's books, less any direct charge offs.

[3]Interest income is recognized on performing balances on a regular accrual basis.

Impaired Loans (dollars in thousands, unaudited)	December 31, 2013 Unpaid Principal Balance(1)	Recorded Investment(2)	Related Allowance	Average Recorded Investment	Interest Income Recognized(3)
With an allowance recorded					
Real estate:					
1-4 family residential construction	$-	$ -	$ -	$ -	$ -
Other construction/land	2,972	2,972	502	3,000	98
1-4 family - closed-end	13,522	13,522	1,324	13,630	260
Equity lines	528	528	123	530	13
Commercial real estate- owner occupied	2,047	2,047	217	2,069	135
Commercial real estate- non-owner occupied	3,715	3,715	701	3,813	238
Farmland	-	-	-	-	-
Total real estate	22,784	22,784	2,867	23,042	744
Agriculture	125	125	126	131	-
Commercial and industrial	4,580	4,345	1,925	4,496	131
Consumer loans	3,411	3,411	431	3,591	172
	30,900	30,665	5,349	31,260	1,047
With no related allowance recorded					
Real estate:					
1-4 family residential construction	-	-	-	-	-
Other construction/land	4,176	3,779	-	3,885	-
1-4 family - closed-end	4,655	4,376	-	4,687	1
Equity lines	565	493	-	493	-
Commercial real estate- owner occupied	7,436	5,516	-	5,568	-
Commercial real estate- non-owner occupied	10,077	9,780	-	9,820	115
Farmland	282	282	-	290	-
Total real estate	27,191	24,226	-	24,743	116
Agriculture	345	345	-	837	-
Commercial and industrial	1,249	1,099	-	1,607	57
Consumer loans	241	52	-	77	-
	29,026	25,722	-	27,264	173
Total	$59,926	$ 56,387	$ 5,349	$ 58,524	$ 1,220

(1)Contractual principal balance due from customer.

(2)Principal balance on Company's books, less any direct charge offs.

(3)Interest income is recognized on performing balances on a regular accrual basis.

The specific loss allowance for an impaired loan generally represents the difference between the face value of the loan and either the fair value of underlying collateral less estimated disposition costs, or the loan’s net present value as determined by a discounted cash flow analysis. The discounted cash flow approach is typically used to measure impairment on loans for which it is anticipated that repayment will be provided from cash flows other than those generated solely by the disposition or operation of underlying collateral. However, historical loss rates may be used to determine a specific loss allowance if they indicate a higher potential reserve need than the discounted cash flow analysis. Any change in impairment attributable to the passage of time is accommodated by adjusting the loss allowance accordingly.

For loans where repayment is expected to be provided by the disposition or operation of the underlying collateral, impairment is measured using the fair value of the collateral. If the collateral value, net of the expected costs of disposition where applicable, is less than the loan balance, then a specific loss reserve is established for the shortfall in collateral coverage. If the discounted collateral value is greater than or equal to the loan balance, no specific loss reserve is required. At the time a collateral-dependent loan is designated as nonperforming, a new appraisal is ordered and typically received within 30 to 60 days if a recent appraisal is not already available. We generally use external appraisals to determine the fair value of the underlying collateral for nonperforming real estate loans, although the Company’s licensed staff appraisers may update older appraisals based on current market conditions and property value trends. Until an updated appraisal is received, the Company uses the existing appraisal to determine the amount of the specific loss allowance that may be required, and adjusts the specific loss allowance, as necessary, once a new appraisal is received. Updated appraisals are generally ordered at least annually for collateral-dependent loans that remain impaired. Current appraisals were available for 93% of the Company’s impaired real estate loan balances at March 31, 2014. Furthermore, the Company analyzes collateral-dependent loans on at least a quarterly basis, to determine if any portion of the recorded investment in such loans can be identified as uncollectible and would therefore constitute a confirmed loss. All amounts deemed to be uncollectible are promptly charged off against the Company’s allowance for loan and lease losses, with the loan then carried at the fair value of the collateral, as appraised, less estimated costs of disposition if applicable. Once a charge-off or write-down is recorded, it will not be restored to the loan balance on the Company’s accounting books.

Our methodology also provides that a “general” allowance be established for probable incurred losses inherent in loans and leases that are not impaired. Unimpaired loan balances are segregated by credit quality, and are then evaluated in pools with common characteristics. At the present time, pools are based on the same segmentation of loan types presented in our regulatory filings. While this methodology utilizes historical loss data and other measurable information, the classification of loans and the establishment of the allowance for loan and lease losses are both to some extent based on management’s judgment and experience. Our methodology incorporates a variety of risk considerations, both quantitative and qualitative, in establishing an allowance for loan and lease losses that management believes is appropriate at each reporting date. Quantitative information includes our historical loss experience, delinquency and charge-off trends, and current collateral values. Qualitative factors include the general economic environment in our markets and, in particular, the condition of the agricultural industry and other key industries in the Central San Joaquin Valley. Lending policies and procedures (including underwriting standards), the experience and abilities of lending staff, the quality of loan review, credit concentrations (by geography, loan type, industry and collateral type), the rate of loan portfolio growth, and changes in legal or regulatory requirements are additional factors that are considered. The total general reserve established for probable incurred losses on unimpaired loans was $6.250 million at March 31, 2014.

During the three months ended March 31, 2014, there were no material changes to the methodology used to determine our allowance for loan and lease losses. As we add new products and expand our geographic coverage, and as the economic environment changes, we expect to continue to enhance our methodology to keep pace with the size and complexity of the loan and lease portfolio and respond to pressures created by external forces. We engage outside firms on a regular basis to assess our methodology and perform independent credit reviews of our loan and lease portfolio. In addition, the Company’s external auditors, the FDIC, and the California DBO review the allowance for loan and lease losses as an integral part of their audit and examination processes. Management believes that the current methodology is appropriate given our size and level of complexity.

The tables that follow detail the activity in the allowance for loan and lease losses for the periods noted:

Allowance for Credit Losses and Recorded Investment in Financing Receivables

(dollars in thousands, unaudited)

	For the Quarter Ended March 31, 2014					
	Real Estate	Agricultural	Commercial and Industrial	Consumer	Unallocated	Total
Allowance for credit losses:						
Beginning balance	$5,544	$ 978	$ 3,787	$ 1,117	$ 251	$11,677
Charge-offs	(126)	(124)	(187)	(421)	-	(858)
Recoveries	307	1	44	170	-	522
Provision	1,671	(8)	(2,226)	572	141	150
Ending Balance	$7,396	$ 847	$ 1,418	$ 1,438	$ 392	$11,491
Reserves:						
Specific	$4,399	$ -	$ 617	$ 224	$ -	$5,240
General	2,997	847	801	1,214	392	6,251
Ending balance	$7,396	$ 847	$ 1,418	$ 1,438	$ 392	$11,491
Loans evaluated for impairment:						
Individually	$47,967	$ 327	$ 3,541	$ 3,309	$ -	$55,144
Collectively	577,248	25,699	160,999	18,671	-	782,617
Ending balance	$625,215	$ 26,026	$ 164,540	$ 21,980	$ -	$837,761

	For the Year Ended December 31, 2013					
	Real Estate	Agricultural	Commercial and Industrial	Consumer	Unallocated	Total
Allowance for credit losses:						
Beginning Balance	$8,034	$ 258	$ 3,467	$ 2,114	$ -	$13,873
Charge-offs	(4,205)	(473)	(1,668)	(1,917)	-	(8,263)
Recoveries	618	-	802	297	-	1,717
Provision	1,097	1,193	1,186	623	251	4,350
Ending balance	$5,544	$ 978	$ 3,787	$ 1,117	$ 251	$11,677
Reserves:						

Specific	$2,867	$ 126	$ 1,925	$ 431		$5,349
General	2,677	852	1,862	686	251	6,328
Ending balance	$5,544	$ 978	$ 3,787	$ 1,117	$ 251	$11,677
Loans evaluated for impairment:						
Individually	$47,010	$ 470	$ 5,444	$ 3,463	$ -	$56,387
Collectively	530,829	24,710	171,243	20,073	-	746,855
Ending balance	$577,839	$ 25,180	$ 176,687	$ 23,536	$ -	$803,242

Note 13 – Recent Developments

On July 2, 2013, the Federal Reserve Board approved final rules that implement changes to the regulatory capital framework for financial institutions. The new rules include, among other things, the following elements:

1) a new regulatory capital component referred to as “Common Equity Tier 1 capital”, and threshold ratios for this new component;
2) a “capital conservation buffer” above the minimum required level of regulatory capital, and restrictions on dividend payments, share buybacks, and certain discretionary bonus payments to executive officers if a capital conservation buffer of at least 2.5% of risk-weighted assets is not achieved;
3) the inclusion of accumulated other comprehensive income (AOCI) in Tier 1 capital, although banks with less than $250 billion in total assets will be allowed a one-time opt-out from this requirement;
4) additional constraints on the inclusion of minority interests, mortgage servicing assets, and deferred tax assets in regulatory capital;
5) increased risk-weightings for certain assets, including equity exposures, certain acquisition/development and construction loans, and loans that are more than 90-days past due or are on non-accrual status; and
6) an increase in minimum required risk-based capital ratios effective January 1, 2015, and an increase in the threshold for a “well-capitalized” classification for the Tier 1 Risk-Based Capital Ratio.

These changes begin to take effect January 2015, and our preliminary estimates indicate that we are well-positioned to absorb the impact without constraining organic growth plans, although no assurance can be provided in that regard.

PART I - FINANCIAL INFORMATION

ITEM 2

MANAGEMENT'S DISCUSSION AND

ANALYSIS OF FINANCIAL CONDITION

AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This Form 10-Q includes forward-looking statements that involve inherent risks and uncertainties. Words such as "expects", "anticipates", "believes", "projects", and "estimates" or variations of such words and similar expressions are intende to identify forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed, forecast in, or implied by such forward-looking statements.

A variety of factors could have a material adverse impact on the Company's financial condition or results of operations, and should be considered when evaluating the Company's potential future financial performance. They include, but are not limited to, unfavorable economic conditions in the Company's service areas; risks associated with fluctuations in interest rates; liquidity risks; increases in nonperforming assets and net credit losses that could occur, particularly in times of weak economic conditions or rising interest rates; the Company's ability to secure buyers for foreclosed properties; reductions in the market value of available-for-sale securities that could result if interest rates change substantially or an issuer has real or perceived financial difficulties; the Company's ability to attract and retain skilled employees; the Company's ability to successfully deploy new technology; the success of branch expansion; and risks associated with the multitude of current and prospective laws and regulations to which the Company is and will be subject.

CRITICAL ACCOUNTING POLICIES

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States. The financial information and disclosures contained within those statements are significantly impacted by management's estimates and judgments, which are based on historical experience and various other assumptions that are believed to be reasonable under current circumstances. Actual results may differ from those estimates under divergent conditions.

Critical accounting policies are those that involve the most complex and subjective decisions and assessments, and have the greatest potential impact on the Company's stated results of operations. In management's opinion, the Company's critical accounting policies deal with the following areas: the establishment of the Company's allowance for loan and lease losses, as explained in detail in Note 12 to the consolidated financial statements and the "Provision for Loan and Lease Losses" and "Allowance for Loan and Lease Losses" sections of this discussion and analysis; the valuation of impaired loans and foreclosed assets, which is discussed in Note 11 to the consolidated financial statements and in the "Nonperforming Assets" and "Allowance for Loan and Lease Losses" sections of this discussion and analysis; income taxes, especially with regard to the ability of the Company to recover deferred tax assets, as discussed in the "Provision for Income Taxes" and "Other Assets" sections of this discussion and analysis; and goodwill, which is evaluated annually for impairment based on the fair value of the Company as discussed in the "Other Assets" section of this discussion and analysis. Critical accounting areas are evaluated on an ongoing basis to ensure that the Company's financial statements incorporate the most recent expectations with regard to those areas.

OVERVIEW OF THE RESULTS OF OPERATIONS

AND FINANCIAL CONDITION

results of operations Summary

First Quarter 2014 compared to First Quarter 2013

Net income for the quarter ended March 31, 2014 was $3.799 million, representing an increase of $1.465 million, or 63%, relative to net income of $2.334 million for the quarter ended March 31, 2013. Basic and diluted earnings per share for the first quarter of 2014 were $0.27 and $0.26, respectively, compared to $0.17 and $0.16, respectively, for the first quarter of 2013. The Company's annualized return on average equity was 8.36% and annualized return on average assets was 1.09% for the quarter ended March 31, 2014, compared to 5.42% and 0.68%, respectively, for the quarter ended March 31, 2013. The primary drivers behind the variance in net income are as follows:

- The single largest factor was a reduction of $1.450 million, or 91%, in our loan loss provision.
- Total non-interest expense was also down $1.090 million, or 9%, primarily due to a non-recurring net gain of $723,000 on the sale foreclosed assets in the first quarter of 2014 relative to a net loss of $487,000 on the sale of foreclosed assets in the first quarter of 2013.
- Net interest income reflects an increase of $368,000, or 3%, due to a 3 basis point increase in the Company's net interest margin combined with higher average interest-earning assets.
- Total non-interest income fell by $403,000, or 10%, as a result of lower service charges on deposit accounts due in part to the non-recurring impact of our core software conversion, a drop in income on bank-owned life insurance associated with deferred compensation plans, and a $100,000 non-recurring signing incentive received in conjunction with our conversion of merchant processing to a new vendor in the first quarter of 2013.
- The Company's provision for income taxes was 25% of pre-tax income in the first quarter of 2014 relative to 8% in the first quarter of 2013, with the higher tax provisioning rate in 2014 resulting from an increase in taxable income relative to the Company's available tax credits.

Financial Condition Summary

March 31, 2014 relative to December 31, 2013

The most significant characteristics of, and changes in, the Company's balance sheet during the first three months of 2014 are outlined below:

- The Company's assets totaled $1.458 billion at March 31, 2014, an increase of $48 million, or 3%, relative to total assets of $1.410 billion at December 31, 2013 due to an increase in loan balances and growth in investment securities.

- Gross loans increased by $35 million, or 4%, due in large part to the purchase of $33 million in residential mortgage loans.

- Total nonperforming assets, including nonperforming loans and foreclosed assets, were reduced by $2.2 million, or 5%, to $43.4 million at March 31, 2014 from $45.6 million at December 31, 2013.

- Investment balances were up $20 million, or 5%, for the first quarter of 2014 due to the purchase of mortgage-backed securities as we deployed excess liquidity.

- Total deposits reflect growth of $46 million, or 4%, during the three months ended March 31, 2014. Core non-maturity deposits were up $56 million, or 7%, although much of the increase appears to be seasonal.

- Total capital increased by $2.5 million, or 1%, to $184 million at March 31, 2014, due primarily to an increase in retained earnings net of the impact of the Company's stock repurchases during the quarter. While still robust, our consolidated total risk-based capital ratio declined to 20.96% at March 31, 2014 from 21.67% at year-end 2013. Our tier one risk-based capital ratio was 19.74% and our tier one leverage ratio was 14.26% at March 31, 2014.

EARNINGS PERFORMANCE

The Company earns income from two primary sources. The first is net interest income, which is interest income generated by earning assets less interest expense on interest-bearing liabilities. The second is non-interest income, which consists mainly of customer service charges and fees but also comes from non-customer sources such as bank-owned life insurance. The majority of the Company’s non-interest expense is comprised of operating costs that relate to providing a full range of banking services to our customers.

Net interest income AND NET INTEREST MARGIN

In a reversal of recent adverse trends, net interest income increased by $368,000, or 3%, for the first quarter of 2014 relative to the first quarter of 2013. The level of net interest income recognized in any given period depends on a combination of factors including the average volume and yield for interest-earning assets, the average volume and cost of interest-bearing liabilities, and the mix of products which comprise the Company’s earning assets, deposits, and other interest-bearing liabilities. Net interest income is also impacted by the reversal of interest for loans placed on non-accrual status during the reporting period, and the recovery of interest on loans that had been on non-accrual and were paid off, sold or returned to accrual status.

The following table shows average balances for significant balance sheet categories, and the amount of interest income or interest expense associated with each applicable category for the noted periods. The table also displays the calculated yields on each major component of the Company’s investment and loan portfolios, the average rates paid on each key segment of the Company’s interest-bearing liabilities, and our net interest margin for the noted periods.

Average Balances and Rates (dollars in thousands, except per share data)	For the Three Months Ended Ended March 31, 2014				For the Three Months Ended Ended March 31, 2013			
	Average Balance (1)	Income/ Expense	Average Rate/Yield (2)(3)		Average Balance (1)	Income/ Expense	Average Rate/Yield (2)(3)	
Assets								
Investments:								
Federal funds sold/due from time	$58,581	$35	0.24	%	$45,258	$28	0.25	%
Taxable	336,039	1,825	2.17	%	311,076	1,145	1.47	%
Non-taxable	96,512	741	4.65	%	76,505	619	4.90	%
Equity	2,513	-	-		1,938	17	3.51	%
Total investments	493,645	2,601	2.42	%	434,777	1,809	1.96	%
Loans and Leases:(4)								
Real estate	584,048	7,882	5.47	%	545,632	7,474	5.56	%
Agricultural	24,789	266	4.35	%	23,801	233	3.97	%
Commercial	97,009	1,073	4.49	%	99,922	1,258	5.11	%
Consumer	23,334	492	8.55	%	27,196	557	8.31	%
Mortgage Warehouse Lines	51,923	595	4.65	%	108,674	1,341	5.00	%
Direct financing leases	2,481	34	5.56	%	3,394	49	5.86	%
Other	270	9	13.52	%	12	-	-	
Total loans and leases	783,854	10,351	5.36	%	808,631	10,912	5.47	%
Total interest earning assets (5)	1,277,499	12,952	4.23	%	1,243,408	12,721	4.26	%
Other earning assets	5,932				6,370			
Non-earning assets	132,949				142,830			
Total assets	$1,416,380				$1,392,608			
Liabilities and shareholders' equity								
Interest bearing deposits:								
Demand deposits	90,607	60	0.27	%	$83,086	$74	0.36	%
NOW	218,990	82	0.15	%	196,399	98	0.20	%
Savings accounts	148,420	76	0.21	%	127,629	65	0.21	%
Money market	71,727	20	0.11	%	75,698	30	0.16	%
CDAR's	13,063	9	0.28	%	14,785	14	0.38	%
Certificates of deposit<$100,000	79,133	90	0.46	%	100,394	117	0.47	%
Certificates of deposit≥$100,000	204,765	194	0.38	%	215,070	218	0.41	%
Brokered deposits	6,778	27	1.62	%	13,167	44	1.36	%
Total interest bearing deposits	833,483	558	0.27	%	826,228	660	0.32	%
Borrowed Funds:								
Federal funds purchased	1	-	-		1	-	-	
Repurchase agreements	6,444	5	0.31	%	1,650	3	0.74	%
Short term borrowings	-	-	-		1,989	1	0.20	%
Long term borrowings	-	-	-		4,222	33	3.17	%
TRUPS	30,928	174	2.28	%	30,928	177	2.32	%
Total borrowed funds	37,373	179	1.94	%	38,790	214	2.24	%
Total interest bearing liabilities	870,856	737	0.34	%	865,018	874	0.41	%
Demand deposits - non-interest bearing	342,574				334,268			

Other liabilities	18,562			18,649		
Shareholders' equity	184,388			174,673		
Total liabilities and shareholders' equity	$1,416,380			$1,392,608		
Interest income/interest earning assets			4.23 %			4.25 %
Interest expense/interest earning assets			0.23 %			0.28 %
Net interest income and margin[(6)]		$12,215	4.00 %		$11,847	3.97 %

(1) Average balances are obtained from the best available daily or monthly data and are net of deferred fees and related direct costs.

(2) Yields and net interest margin have been computed on a tax equivalent basis utilizing a 34% effective tax rate.

(3) Annualized

(4) Loan costs have been included in the calculation of interest income. Loan costs were approximately $(152) thousand and $(61) thousand for the quarters ended March 31, 2014 and 2013.
Loans are gross of the allowance for possible loan losses.

(5) Non-accrual loans have been included in total loans for purposes of total earning assets.

(6) Net interest margin represents net interest income as a percentage of average interest-earning assets.

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The Volume and Rate Variances table below sets forth the dollar difference in interest earned or paid for each major category of interest-earning assets and interest-bearing liabilities for the noted periods, and the amount of such change attributable to changes in average balances (volume) or changes in average interest rates. Volume variances are equal to the increase or decrease in average balance multiplied by prior period rates, and rate variances are equal to the increase or decrease in rate times prior period average balances. Variances attributable to both rate and volume changes are calculated by multiplying the change in rate by the change in average balance, and have been allocated to the rate variance.

Volume & Rate Variances (dollars in thousands)	Quarter Ended March 31, 2014 over 2013 Increase(decrease) due to		
	Volume	Rate	Net
Assets:			
Investments:			
Federal funds sold / Due from time	$8	$(1)	$7
Taxable	92	588	680
Non-taxable[(1)]	162	(40)	122
Equity	5	(22)	(17)
Total Investments	267	526	792
Loans and Leases:			
Real Estate	526	(118)	408
Agricultural	10	23	33
Commercial	(37)	(148)	(185)
Consumer	(79)	14	(65)
Mortgage Warehouse Lines	(700)	(46)	(746)
Direct Financing Leases	(13)	(2)	(15)
Other	-	9	9
Total Loans and Leases	(292)	(269)	(561)
Total Interest Earning Assets	$(26)	$257	$231
Liabilities			
Interest Bearing Deposits:			
Demand Deposits	$7	$(21)	$(14)
NOW	11	(27)	(16)
Savings Accounts	11	0	11
Money Market	(2)	(8)	(10)
CDAR's	(2)	(3)	(5)
Certificates of Deposit < $100,000	(25)	(2)	(27)
Certificates of Deposit ≥ $100,000	(10)	(14)	(24)
Brokered Deposits	(21)	4	(17)
Total Interest Bearing Deposits	(31)	(71)	(102)
Borrowed Funds:			
Repurchase Agreements	9	(7)	2
Short Term Borrowings	(1)	-	(1)
Long Term Borrowings	(33)	-	(33)

TRUPS	-	(3)	(3)
Total Borrowed Funds	(25)	(10)	(35)
Total Interest Bearing Liabilities	$(57)	$(81)	$(137)
Net Interest Margin/Income	$30	$338	$368

(1) Yields on tax exempt income have not been computed on a tax equivalent basis.

The volume variance calculated for the first quarter of 2014 relative to the first quarter of 2013 was a favorable $30,000, due primarily to a $34 million increase in average interest-earning assets. The volume variance for the comparative quarters was enhanced by migration within average deposit balances from time deposits into lower-cost non-maturity deposits, but was negatively impacted by a volume shift from higher-yielding loans into lower yielding investments. Average loans and leases fell by $25 million while average investment balances increased $59 million, including a $13 million increase in the average balance held in our Federal Reserve Bank (FRB) account.

The impact of interest rate changes resulted in a $338,000 favorable rate variance in net interest income for the comparative quarters. Our weighted average yield on interest-earning assets fell 3 basis points due to lower loan rates stemming from continued competition for quality loans, partially offset by a higher yield on our investment portfolio. By comparison, our weighted average cost of interest-bearing liabilities was 7 basis points lower due primarily to a slight drop in deposit rates. Also impacting our rate variance were $8,000 in net interest recoveries in the first quarter of 2014, relative to $11,000 in net interest reversals in the first quarter of 2013.

The Company's net interest margin, which is tax-equivalent net interest income as a percentage of average interest-earning assets, is affected by the same factors discussed above relative to rate and volume variances. Our net interest margin was 4.00% in the first quarter of 2014, an increase of 3 basis points relative to the first quarter of 2013. The principal factors favorably impacting our net interest margin in the first quarter of 2014 include the drop in deposit rates and the shift from higher-cost time deposits into lower-cost non-maturity deposits. Partially offsetting the favorable factors were competitive pressures on loan yields and the shift from average loans into investments.

Provision for loan and LEASE losses

Credit risk is inherent in the business of making loans. The Company sets aside an allowance for loan and lease losses, a contra-asset account, through periodic charges to earnings which are reflected in the income statement as the provision for loan and lease losses. The Company's loan loss provision totaled $150,000 for the first quarter of 2014 and $1.600 million for the first quarter of 2013, representing a quarter over quarter reduction of $1.450 million, or 91%.

The Company's loan loss provision has been sufficient to maintain our allowance for loan and lease losses at a level that, in management's judgment, is adequate to absorb probable loan losses related to specifically-identified impaired loans as well as probable incurred losses in the remaining loan portfolio. Specifically identifiable and quantifiable loan losses are immediately charged off against the allowance. Net loans charged off totaled $336,000 in the first quarter of 2014 relative to $2.274 million in the first quarter of 2013, for a reduction of $1.938 million, or 85%. The majority of loan charge-offs in 2014 have been recorded against reserves established in previous periods, which minimized the need for reserve replenishment in the current period, thus our loan loss provision in 2014 has been utilized primarily to supplement general reserves for losses inherent in incrementally higher non-impaired loan balances.

The Company's policies for monitoring the adequacy of the allowance and determining loan amounts that should be charged off, and other detailed information with regard to changes in the allowance, are discussed in note 12 to the consolidated financial statements and below under "Allowance for Loan and Lease Losses." The process utilized to establish an appropriate allowance for loan and lease losses can result in a high degree of variability in the Company's loan loss provision, and consequently in our net earnings.

NON-INTEREST INCOME and NON-INTEREST expense

The following table provides details on the Company's non-interest income and non-interest expense for the three-month periods ended March 31, 2014 and 2013:

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Non Interest Income/Expense
(dollars in thousands, unaudited)

	For the Quarter Ended March 31, 2014