2019 Annual Report
Giving Business More Reach

American River Bankshares

TABLE OF CONTENTS

ANNUAL REPORT COPIES. American River Bankshares will provide its security holders and interested parties, without charge, a copy of its 2019 Annual Report on Form 10-K, including the financial statements and schedules thereto, as filed with the Securities and Exchange Commission. To request a copy by mail, please contact American River Bankshares. To view a PDF version online, please go to our web site at www.envisionreports.com/AMRB.

2019 YEAR IN REVIEW

We are pleased to report our 2019 results that demonstrate the outcome of the growth plan we unveiled the prior year.

As projected, we experienced growth in both deposits and loans. This growth tells only part of the story. Our attention to both current and new client relationships was rewarded with a revitalized interest in American River Bank. This interest resulted in satisfying the financial needs of the communities we serve and successfully driving up the interest income by providing innovative lending solutions.

Financial Highlights from 2019

- Net income was $5.5 million, an increase of $600,000 (12.2%) from $4.9 million in 2018.
- Net loans increased $75.3 million (23.6%) and core deposits* increased $28.4 million (5.7%) over 2018.
- Net interest income was $23.2 million, compared to $20.6 million for the twelve months ended December 31, 2018. This reflects a net interest margin of 3.60% for 2019 compared to 3.41% in 2018.
- Loan and lease losses allowance at December 31, 2019 was $5.1 million (1.29% of total loans and leases), compared to $4.4 million (1.36% of total loans and leases) at December 31, 2018. There were no nonperforming loans at December 31, 2019 and just $27,000 at December 31, 2018.
- Shareholders' equity was $82.9 million compared to $74.7 million at December 31, 2018. Tangible book value per share was $11.29 compared to $9.97 at December 31, 2018. Book value per share was $14.06 per share compared to $12.75 per share at December 31, 2018.
- The Company continued the quarterly cash dividend by paying a $0.07 per share cash dividend on November 12, 2019. Cash dividends per share for the year ended December 31, 2019 were $0.24, compared to $0.20 for the year ended December 31, 2018.
- The Company continues to maintain strong capital ratios. Our Leverage ratio was 9.2%; the Tier 1 Risk-Based Capital ratio was 14.8%; and the Total Risk-Based Capital ratio was 15.9%.

Looking back, 2019 was considered a successful year for the Company. We made solid progress despite the challenges of low interest rates, experienced industry-wide, and those unique to our geographic area including devastating fires and unpredictable power outages. Already in 2020 the Coronavirus has caused, and will continue to cause, economic distress. Be assured, our leadership team is prepared for the upcoming challenges. We continue to be responsive and adjust to the ever changing and uncertain environment.

We are grateful to our employees who have worked together and embraced our growth plan. Their commitment to deliver high quality service played a major role in our success in 2019.

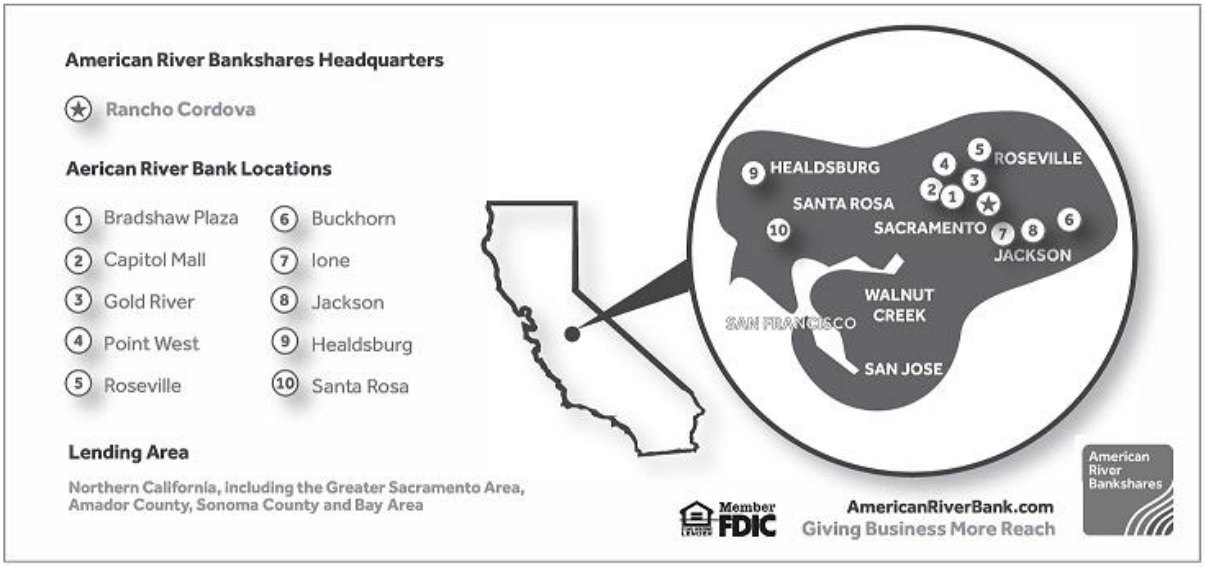
On behalf of the Directors and employees at American River Bankshares, thank you for your confidence and support.

Charles D. Fite
Chairman of the Board

David E. Ritchie, Jr.
President & CEO

*The Company considers all deposits except time deposits as core deposits.

OUR LOCATIONS



ANNUAL MEETING

The 2020 annual meeting of American River Bankshares will be held at 4:00 p.m. on Thursday, May 21, 2020.

OUR TEAM

AMERICAN RIVER BANK AND BANKSHARES BOARD OF DIRECTORS

Charles D. Fite
Chairman of the Board
President, Fite Development Co.

William A. Robotham, CPA
Vice-Chairman of the Board
Former Executive Partner, Pisenti & Brinker LLP

Nicolas C. Anderson
Chief Executive Officer
ArcherHall

Kimberly A. Box
President & Chief Executive Officer, Gatekeeper Innovation, Inc.

Jeffery Owensby
Mediator and Arbitrator, Judicate West

Julie A. Raney, Esq.
Deputy General Counsel, Sutter Health

David E. Ritchie, Jr.
President & Chief Executive Officer, American River Bankshares

Philip A. Wright
President & Owner, Wright Investments Inc. dba Wright Realty

Michael A. Ziegler
President & Chief Executive Officer, PRIDE Industries

AMERICAN RIVER BANK LEADERSHIP TEAM

David E. Ritchie, Jr.
President & Chief Executive Officer

Kevin B. Bender
EVP & Chief Operating Officer

Lisa R. Cisneros
EVP, Retail Banking

Mitchell A. Derenzo
EVP & Chief Financial Officer

Dan C. McGregor
EVP & Chief Credit Officer

Gregory N. Patton
EVP, Commercial Banking

STOCK LISTING

American River Bankshares trades on the NASDAQ Global Select Stock Market under the symbol "AMRB"

INVESTOR RELATIONS

American River Bankshares
3100 Zinfandel Drive, Suite 450
Rancho Cordova, CA 95670
(916) 851-0123
investor.relations@americanriverbank.com
www.AmericanRiverBank.com

TRANSFER AGENCY

Computershare Trust Company
P.O. Box 43070
Providence, RI 02940-3070
(800) 962 4284
www-us.computershare.com/Investor/

HOLDERS

As of February 6, 2020 there were approximately 2,544 shareholders of record of the Company's common stock.

Selected Financial Data.

FINANCIAL SUMMARY-The following table presents certain consolidated financial information concerning the business of the Company and its subsidiaries. This information should be read in conjunction with the Consolidated Financial Statements, the notes thereto, and Management's Discussion and Analysis included in this report.

As of and for the Years Ended December 31,
(In thousands, except per share amounts and ratios)

	2019	2018	2017	2016	2015
Operations Data:					
Net interest income	$ 23,209	$ 20,646	$ 19,353	$ 20,243	$ 20,007
Provision for loan and lease losses	660	175	450	(1,344)	-
Noninterest income	1,688	1,513	1,596	2,045	2,015
Noninterest expenses	16,846	15,510	14,049	13,836	14,080
Income before income taxes	7,391	6,474	6,450	9,796	7,942
Income tax expense	1,891	1,574	3,252	3,392	2,674
Net income	$ 5,500	$ 4,900	$ 3,198	$ 6,404	$ 5,268
Share Data:					
Earnings per share – basic	$ 0.94	$ 0.83	$ 0.50	$ 0.95	$ 0.70
Earnings per share – diluted	$ 0.94	$ 0.83	$ 0.50	$ 0.94	$ 0.70
Cash dividends per share (1)	$ 0.24	$ 0.20	$ 0.20	$ 0.00	$ 0.00
Book value per share	$ 14.06	$ 12.75	$ 12.54	$ 12.59	$ 11.72
Tangible book value per share	$ 11.29	$ 9.97	$ 9.88	$ 10.14	$ 9.50
Balance Sheet Data:					
Assets	$ 720,353	$ 688,092	$ 655,622	$ 651,450	$ 634,640
Loans and leases, net	393,802	318,516	308,713	324,086	289,102
Deposits	604,837	590,674	556,080	544,806	530,690
Shareholders' equity	82,909	74,721	76,921	83,850	86,075
Financial Ratios:					
Return on average equity	6.92%	6.77%	3.91%	7.60%	6.03%
Return on average tangible equity	8.71%	8.74%	4.88%	9.43%	7.42%
Return on average assets	0.78%	0.72%	0.49%	1.00%	0.85%
Efficiency ratio (2)	67.09%	69.35%	65.84%	60.81%	62.87%
Net interest margin (2)	3.60%	3.41%	3.39%	3.62%	3.63%
Net loans and leases to deposits	65.11%	53.92%	55.52%	59.49%	54.48%
Net (recoveries) charge-offs to average loans & leases	(0.02%)	0.08%	0.25%	(0.39%)	0.12%
Nonperforming loans and leases to total loans and leases (3)	0.00%	0.01%	0.60%	0.01%	0.56%
Allowance for loan and lease losses to total loans and leases	1.29%	1.36%	1.43%	1.47%	1.69%
Average equity to average assets	11.30%	10.62%	12.53%	13.20%	14.02%
Dividend payout ratio (1)	26%	24%	40%	0%	0%
Capital Ratios:					
Leverage capital ratio	9.16%	8.94%	9.45%	10.50%	10.97%
Tier 1 risk-based capital ratio	14.77%	16.11%	18.08%	19.02%	19.34%
Total risk-based capital ratio	15.94%	17.29%	19.34%	20.27%	20.59%

(1) On January 25, 2017, the Company reinstated the payment of quarterly cash dividends.
(2) Fully taxable equivalent.
(3) Nonperforming loans and leases consist of loans and leases past due 90 days or more and still accruing and nonaccrual loans and leases.

Management's Discussion and Analysis of Financial Condition and Results of Operations.

This discussion should be read in conjunction with “Item 1. Business-Cautionary Statements Regarding Forward-Looking Statements,” “Item 1A. Risk Factors,” and “Item 8. Financial Statements and Supplementary Data” in our 2019 Form 10-K filed with the Securities and Exchange Commission on February 21, 2020.

Use of Non-GAAP Financial Measures

This Annual Report contains certain non-GAAP (Generally Accepted Accounting Principles) financial measures in addition to results presented in accordance with GAAP. These measures include tangible book value and taxable equivalent basis used in the computation of the net interest margin and efficiency ratio. Management has presented these non-GAAP financial measures in this Form 10K because it believes that they provide useful and comparative information to assess trends in the Company’s financial position reflected in the results and facilitate comparison of our performance with the performance of our peers.

Tangible Equity (non-GAAP financial measures

Tangible common stockholders' equity (tangible book value) excludes goodwill and other intangible assets. The Company believes the exclusion of goodwill and other intangible assets to create “tangible equity” facilitates the comparison of results for ongoing business operations. The Company’s management internally assesses its performance based, in part, on these non-GAAP financial measures. The following table sets forth a reconciliation of total shareholders’ equity to tangible shareholder’s equity for the periods presented.

Reconciliation to Tangible Common Shareholders’ Equity:

	December 31,		
	2019	2018	2017
	(dollars in thousands)		
Total shareholders’ equity	$ 82,909	$ 74,721	$ 76,921
Less:			
Other intangible assets (goodwill)	(16,321)	(16,321)	(16,321)
Tangible common shareholders’ equity	$ 66,588	$ 58,400	$ 60,600

Net Interest Margin and Efficiency Ratio (non-GAAP financial measures)

In accordance with industry standards, certain designated net interest income amounts are presented on a taxable equivalent basis, including the calculation of net interest margin and the efficiency ratio. The Company believes the presentation of net interest margin on a taxable equivalent basis using a 21% effective tax rate for 2019 and 2018 and a 34% effective tax rate for 2017, allows comparability of net interest margin with industry peers by eliminating the effect of the differences in portfolios attributable to the proportion represented by both taxable and tax-exempt loans and investments. The efficiency ratio is a measure of a banking company’s overhead as a percentage of its revenue. The Company derives this ratio by dividing total noninterest expense by the sum of the taxable equivalent net interest income and the total noninterest income.

Reconciliation of Annualized Net Interest Margin, Fully Tax Equivalent (non-GAAP)

(dollars in thousands)	December 31,		
	2019	2018	2017
Net interest income (GAAP)	$ 23,209	$ 20,646	$ 19,353
Tax equivalent adjustment	214	207	390
Net interest income - tax equivalent adjusted (non-GAAP)	$ 23,423	$ 20,853	$ 19,743
Average earning assets	$ 650,627	$ 611,696	$ 582,443
Net interest margin (GAAP)	3.57%	3.38%	3.32%
Net interest margin (non-GAAP)	3.60%	3.41%	3.39%

Reconciliation of Non-GAAP Measure – Efficiency Ratio

(dollars in thousands)	December 31,		
	2019	2018	2017
Net interest income (GAAP)	$ 23,209	$ 20,646	$ 19,353
Tax equivalent adjustment	214	207	390
Net interest income – tax-equivalent adjusted (non-GAAP)	$ 23,423	$ 20,853	$ 19,743
Noninterest income	1,688	1,513	1,596
Total income	25,111	22,366	21,339
Total noninterest expense	16,846	15,510	14,049
Efficiency ratio, fully tax-equivalent (non-GAAP)	67.09%	69.35%	65.84%

Critical Accounting Policies

General

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The financial information contained within our statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. We use historical loss data and the economic environment as factors, among others, in determining the inherent loss that may be present in our loan and lease portfolio. Actual losses could differ significantly from the factors that we use. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of our transactions would be the same, the timing of events that would impact our transactions could change.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses is an estimate of probable credit losses inherent in the Company's credit portfolio that have been incurred as of the balance-sheet date. The allowance is based on two basic principles of accounting: (1) "Accounting for Contingencies," which requires that losses be accrued when it is probable that a loss has occurred at the balance sheet date and such loss can be reasonably estimated; and (2) the "Receivables" topic, which requires that losses be accrued on impaired loans based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

The allowance for loan and lease losses is determined based upon estimates that can and do change when the actual risk, loss events, or changes in other factors, occur. The analysis of the allowance uses a historical loss view as an indicator of future losses and as a result could differ from the actual losses incurred in the future. If the allowance for loan and lease losses falls below that deemed adequate (by reason of loan and lease growth, actual losses, the effect of changes in risk factors, or some combination of these), the Company has a strategy for supplementing the allowance for loan and lease losses, over the short-term. For further information regarding our allowance for loan and lease losses, see "Allowance for Loan and Lease Losses Activity."

Stock-Based Compensation

The Company recognizes compensation expense over the service period in an amount equal to the fair value of all share-based payments which consist of stock options and restricted stock awarded to directors and employees. The fair value of each stock option award is estimated on the date of grant and amortized over the service period using a Black-Scholes-Merton based option valuation model that requires the use of assumptions. Critical assumptions that affect the estimated fair value of each award include expected stock price volatility, dividend yields, option life and the risk-free interest rate. The fair value of each restricted award is estimated on the date of award and amortized over the service period.

Overview

The Company recorded net income in 2019 of $5,500,000, an increase of $600,000 (12.2%) from $4,900,000 in 2018. Diluted earnings per share were $0.94 for 2019 and $0.83 for 2018. For 2019, the Company realized a return on average equity of 6.92% and a return on average assets of 0.78%, compared to 6.77% and 0.72%, respectively, in 2018.

Net income for 2018 increased $1,702,000 (53.2%) from $3,198,000 in 2017. Diluted earnings per share for 2017 were $0.50. For 2017, the Company realized a return on average equity of 3.91% and return on average assets of 0.49%. Table One below provides a summary of the components of net income for the years indicated (dollars in thousands):

Table One: Components of Net Income

	2019	2018	2017
Interest income*	$ 25,884	$ 22,449	$ 20,804
Interest expense	(2,461)	(1,596)	(1,061)
Net interest income*	23,423	20,853	19,743
Provision for loan and lease losses (expense) income	(660)	(175)	(450)
Noninterest income	1,688	1,513	1,596
Noninterest expense	(16,846)	(15,510)	(14,049)
Provision for income taxes	(1,891)	(1,574)	(3,252)
Tax equivalent adjustment	(214)	(207)	(390)
Net income	$ 5,500	$ 4,900	$ 3,198
Average total assets	$ 703,205	$ 681,630	$ 652,720
Net income as a percentage of average total assets	0.78%	0.72%	0.49%

* Fully taxable equivalent basis (FTE)

During 2019, total assets of the Company increased $32,261,000 (4.7%) from $688,092,000 at December 31, 2018 to $720,353,000 at December 31, 2019. At December 31, 2019, net loans totaled $393,802,000, an increase of $75,286,000 (23.6%) from the ending balance of $318,516,000 at December 31, 2018. Deposits increased $14,163,000 or 2.4% from $590,674,000 at December 31, 2018 to $604,837,000 at December 31, 2019. Shareholders' equity increased $8,188,000 or 11.0% from $74,721,000 at December 31, 2018 to $82,909,000 at December 31, 2019. The Company ended 2019 with a leverage capital ratio of 9.2% and a total risk-based capital ratio of 15.9% compared to a leverage capital ratio of 8.9% and a total risk-based capital ratio of 17.3% at the end of 2018.

Results of Operations

Net Interest Income and Net Interest Margin

Net interest income represents the excess of interest and fees earned on interest earning assets (loans, securities, Federal funds sold and interest-bearing deposits in other banks) over the interest paid on deposits and borrowed funds. Net interest margin is net interest income expressed as a percentage of average earning assets.

The Company's fully taxable equivalent net interest margin was 3.60% in 2019, 3.41% in 2018, and 3.39% in 2017. The fully taxable equivalent net interest income increased $2,570,000 (12.3%), from $20,853,000 in 2018 to $23,423,000 in 2019. The fully taxable equivalent net interest income increased $1,110,000 (5.6%), from $19,743,000 in 2017 to $20,853,000 in 2018.

The fully taxable equivalent interest income component increased $3,435,000 (15.3%) from $22,449,000 in 2018 to $25,884,000 in 2019. The increase in the fully taxable equivalent interest income for 2019 compared to the same period in 2018 is comprised of two components - rate (up $1,335,000) and volume (up $2,100,000). The primary driver in this rate increase was an increase in the yield on loans which saw an increase from 4.72% in 2018 to 4.95% in 2019 and an increase in the yield on investments, which saw an increase from 2.66% in 2018 to 2.81% in 2019. The increased yield in 2019 compared to 2018 was due to the overall higher interest rate environment. The yield on earning assets increased from 3.67% during 2018 to 3.98% during 2019. The volume increase of $2,100,000 was primarily from an increase in loans ($2,394,000) and interest-bearing deposits in banks ($153,000), partially offset by a decrease in investment balances ($103,000) and Federal funds ($345,000). Average loans balances increased $50,964,000, (or 16.5%), from $308,365,000 during 2018 to $359,329,000 during 2019, average interest-bearing deposits in banks increased $168,000, (or 509.1%), from $33,000 during 2018 to $201,000 during 2019 average investment balances decreased $1,602,000, (or 0.6%), from $282,898,000 during 2018 to $281,296,000 in

2019, and average Federal funds decreased $18,515,000, (or 99.1%), from $18,688,000 during 2018 to $173,000 in 2019.

The fully taxable equivalent interest income component increased $1,645,000 (7.9%) from $20,804,000 in 2017 to $22,449,000 in 2018. The increase in the fully taxable equivalent interest income for 2018 compared to the same period in 2017 is comprised of two components - rate (up $1,764,000) and volume (down $119,000). The primary driver in this rate increase was an increase in the yield on loans which saw an increase from 4.57% in 2017 to 4.72% in 2018 and an increase in the yield on investments, which saw an increase from 2.36% in 2017 to 2.66% in 2018. The increased yield in 2018 compared to 2017 was due to the overall higher interest rate environment. The yield on earning assets increased from 3.57% during 2017 to 3.67% during 2018. The increase in yield from the loans and investments was partially offset by an increase in the balances of Federal funds sold. Federal funds sold balances increased from zero in 2017 to an average balance of $18,688,000 in 2018. However, the yield on these lower earning Federal fund balances was 1.86%, thus partially reducing the overall yield on earning assets. The volume decrease of $119,000 was primarily from a decrease in loans ($515,000), partially offset by an increase in investment balances ($391,000). Average loans balances decreased $11,266,000, (or 3.5%), from $319,631,000 during 2017 to $308,365,000 during 2018 and the average investment balances increased $21,344,000, (or 8.2%), from $261,554,000 during 2017 to $282,898,000 in 2018.

Interest expense was $865,000 (or 54.2%) higher in 2019 compared to 2018, increasing from $1,596,000 to $2,461,000. The $865,000 increase in interest expense during 2019 compared to 2018 was due to higher rates (up $745,000) and higher volume (up $120,000). The increase in interest expense can be attributed to an increase in rates paid on deposit and borrowing balances during a higher interest rate environment. Rates paid on interest bearing liabilities increased 22 basis points from 0.41% to 0.63% for 2018 compared to 2019. The largest increase due to rates occurred in interest checking and money market accounts and in the time deposits. The rate paid on interest checking and money market accounts increased from 0.14% during 2018 to 0.34% during 2019 and accounted for $300,000 of the $745,000 increase attributed to rates. The rate paid on time deposit accounts increased from 1.86% during 2018 to 2.89% during 2019 and accounted for $342,000 of the $745,000 increase attributed to rates. The volume increase of $120,000 was attributed to an increase in average time deposit balances which increased from $79,422,000 during 2018 to $85,723,000 during 2019 and accounted for $84,000 of the $120,000 increase and an increase in average other borrowings which increased from $15,533,000 during 2018 to $18,430,000 during 2019 and accounted for $44,000 of the $120,000 increase.

Interest expense was $535,000 (or 50.4%) higher in 2018 compared to 2017, increasing from $1,061,000 to $1,596,000. The $535,000 increase in interest expense during 2018 compared to 2017 was due to higher rates (up $531,000) and higher volume (up $4,000). The increase in interest expense can be attributed to an increase in rates paid on deposit and borrowing balances during a higher interest rate environment. Rates paid on interest bearing liabilities increased 11 basis points from 0.30% to 0.41% for 2017 compared to 2018. The largest increase due to rates occurred in the time deposits. Some of these time deposits are indexed to the three- or six-month treasury rates which have increased over the past twelve months. Interest expense on time deposits increased by $367,000, (or 52.9%), from $694,000 in 2017 to $1,061,000 in 2018 while the average time deposit balances decreased by $1,634,000, (or 2.0%), from $81,056,000 in 2017 to $79,422,000 in 2018.

Table Two, Analysis of Net Interest Margin on Earning Assets, and Table Three, Analysis of Volume and Rate Changes on Net Interest Income and Expenses, are provided to enable the reader to understand the components and past trends of the Company's interest income and expenses. Table Two provides an analysis of net interest margin on earning assets setting forth average assets, liabilities and shareholders' equity; interest income earned and interest expense paid and average rates earned and paid; and the net interest margin on earning assets. Table Three sets forth a summary of the changes in interest income and interest expense from changes in average asset and liability balances (volume), computed on a daily average basis, and changes in average interest rates.

Table Two: Analysis of Net Interest Margin on Earning Assets

Year Ended December 31, (Taxable Equivalent Basis) (dollars in thousands)	2019 Avg Balance	2019 Interest	2019 Avg Yield	2018 Avg Balance	2018 Interest	2018 Avg Yield	2017 Avg Balance	2017 Interest	2017 Avg Yield
Assets:									
Earning assets:									
Taxable loans and leases (1)	$ 338,775	$ 16,834	4.97%	$ 294,114	$ 13,924	4.73%	$ 305,345	$ 13,947	4.57%
Tax-exempt loans and leases (2)	20,554	942	4.58%	14,251	632	4.43%	14,286	667	4.67%
Taxable investment Securities	271,779	7,589	2.79%	264,247	6,901	2.61%	238,710	5,287	2.21%
Tax-exempt investment securities (2)	9,517	313	3.29%	18,651	611	3.28%	22,789	874	3.84%
Corporate stock	-	-	-	-	-	-	55	16	29.09%
Federal funds sold	173	5	2.89%	18,688	348	1.86%	-	-	-
Interest bearing deposits in other banks	9,829	201	2.04%	1,745	33	1.89%	1,258	13	1.03%
Total earning assets	650,627	25,884	3.98%	611,696	22,449	3.67%	582,443	20,804	3.57%
Cash & due from banks	16,440			34,535			35,876		
Other assets	40,878			39,822			39,201		
Allowance for loan & lease losses	(4,740)			(4,423)			(4,800)		
Total average assets	$ 703,205			$ 681,630			$ 652,720		
Liabilities & Shareholders' Equity:									
Interest bearing liabilities:									
NOW & MMDA	$ 212,499	563	0.26%	$ 219,742	272	0.12%	$ 197,298	139	0.07%
Savings	74,304	28	0.04%	71,742	26	0.04%	64,880	22	0.03%
Time deposits	85,723	1,487	1.73%	79,422	1,061	1.34%	81,056	694	0.86%
Other borrowings	18,430	383	2.08%	15,533	237	1.53%	15,522	206	1.33%
Total interest bearing liabilities	390,956	2,461	0.63%	386,439	1,596	0.41%	358,756	1,061	0.30%
Demand deposits	222,616			215,721			204,565		
Other liabilities	10,136			7,062			7,583		
Total liabilities	623,708			609,222			570,904		
Shareholders' equity	79,497			72,408			81,816		
Total average liabilities and shareholders' equity	$ 703,205			$ 681,630			$ 652,720		
Net interest income & margin (3)		$ 23,423	3.60%		$ 20,853	3.41%		$ 19,743	3.39%

(1) Loan and lease interest includes loan and lease fees of $257,000, $533,000 and $238,000 in 2019, 2018 and 2017, respectively.
(2) Includes taxable-equivalent adjustments that primarily relate to income on certain loans and securities that is exempt from federal income taxes. The effective federal statutory tax rate was 21% in 2019 and 2018 and 34% in 2017.
(3) Net interest margin is computed by dividing net interest income by total average earning assets.

Table Three: Analysis of Volume and Rate Changes on Net Interest Income and Expenses

Year ended December 31, 2019 over 2018 (dollars in thousands)
Increase (decrease) in interest income and expense
due to change in:

Interest-earning assets:	Volume	Rate (4)	Net Change
Taxable net loans and leases (1)(2)	$ 2,114	$ 796	$ 2,910
Tax-exempt net loans and leases (3)	280	30	310
Taxable investment securities	197	491	688
Tax-exempt investment securities (3)	(299)	1	(298)
Federal funds sold	(345)	2	(343)
Interest-bearing deposits in other banks	153	15	168
Total interest on earning assets	2,100	1,335	3,435
Interest-bearing liabilities:			
Interest checking and money market	(9)	300	291
Savings deposits	1	1	2
Time deposits	84	342	426
Other borrowings	44	102	146
Total interest on interest-bearing liabilities	120	745	865
Interest differential	$ 1,980	$ 590	$ 2,570

Year Ended December 31, 2018 over 2017 (dollars in thousands)
Increase (decrease) in interest income and expense
due to change in:

Interest-earning assets:	Volume	Rate (4)	Net Change
Taxable net loans and leases (1)(2)	$ (513)	$ 490	$ (23)
Tax-exempt net loans and leases (3)	(2)	(33)	(35)
Taxable investment securities	566	1,048	1,614
Tax-exempt investment securities (3)	(159)	(104)	(263)
Corporate stock	(16)	-	(16)
Federal funds sold	-	348	348
Interest bearing deposits in other banks	5	15	20
Total interest on earning assets	(119)	1,764	1,645
Interest-bearing liabilities:			
Interest checking and money market	16	117	133
Savings deposits	2	2	4
Time deposits	(14)	381	367
Other borrowings	-	31	31
Total interest on interest-bearing liabilities	4	531	535
Interest differential	$ (123)	$ 1,233	$ 1,110

(1) The average balance of non-accruing loans and leases is immaterial as a percentage of total loans and leases and has been included in net loans and leases.
(2) Loan and lease fees of $257,000, $533,000 and $238,000 for the years ended December 31, 2019, 2018 and 2017, respectively, have been included in the interest income computation.
(3) Includes taxable-equivalent adjustments that primarily relate to income on certain loans and securities that is exempt from federal income taxes. The effective federal statutory tax rate was 21% in 2019 and 2018 and 34% in 2017.
(4) The rate/volume variance has been included in the rate variance.

Provision for Loan and Lease Losses

The Company experienced net loan and lease recoveries of $86,000 or -0.02% of average loans and leases during 2019 and recorded a provision for loan and lease losses of $660,000 to support the Company's loan growth during the year. The Company experienced net loan and lease losses of $261,000 or 0.08% of average loans and leases during 2018, compared to net loan and lease losses of $794,000 or 0.25% of average loans and leases during 2017. To support the net losses in 2018 and 2017, the Company recorded provisions for loan and lease losses of $175,000 and $450,000, respectively during 2018 and 2017. The level of nonperforming loans and leases, which began to increase during the economic cycle of 2007 through 2010, reached a high of $22,571,000 at December 31, 2010, but has decreased to zero at December 31, 2019. For additional information see the "Nonaccrual, Past Due and Restructured Loans and Leases" and the "Allowance for Loan and Lease Losses Activity."

Noninterest Income

Table Four below provides a summary of the components of noninterest income for the periods indicated (dollars in thousands):

Table Four: Components of Noninterest Income

	Year Ended December 31,		
	2019	2018	2017
Service charges on deposit accounts	$ 558	$ 476	$ 465
Merchant fee income	391	422	411
Earnings on bank-owned life insurance	334	307	317
Gain on sale of securities	115	31	161
Other	290	277	242
	$ 1,688	$ 1,513	$ 1,596

Noninterest income increased $175,000 (11.6%) to $1,688,000 in 2019 from $1,513,000 in 2018. The increase from 2018 to 2019 was primarily related to higher gains on sale of securities which increased $84,000 (271.0%) from 2018 to 2019 and an increase in service charges on deposit accounts which increased $82,000 (17.2%) from $476,000 in 2018 to $558,000 in 2019.

Noninterest income decreased $83,000 (5.2%) to $1,513,000 in 2018 from $1,596,000 in 2017. The decrease from 2017 to 2018 was primarily related to lower gains on sale of securities. Gain on sales of securities decreased $130,000 (81.3%) from 2017 to 2018.

Noninterest Expense

Salaries and Benefits

Salaries and benefits were $11,316,000 (up $1,113,000 or 10.9%) for 2019, compared to $10,203,000 in 2018. The increase in salaries and benefits expense resulted from a full year of salary and benefits for new hires in 2018 including additional relationship managers and lending support personnel, as well as, increased incentive payments to the relationship managers due to the increased loan production in 2019. Salary expense in 2019 also includes normal cost of living increases and promotions. Average full-time equivalent employees was 102 during 2019 compared to 97 during 2018. Employer benefit expenses, such as insurance, 401(k) matching and incentives and payroll taxes increased commensurate with the increased staffing levels.

Salaries and benefits were $10,203,000 (up $1,283,000 or 14.4%) for 2018, compared to $8,920,000 in 2017. The increase in salaries and benefits expense resulted from filling some vacant positions, hiring additional relationship managers, creating a position for a Chief Lending Officer in December 2017, and normal cost of living increases and promotions. Average full-time equivalent employees was 97 during 2018 compared to 93 during 2017. Employer benefit expenses, such as insurance, 401(k) matching and incentives and payroll taxes increased commensurate with the increased staffing levels.

Other Real Estate Owned

The total other real estate owned ("OREO") expense in 2019 was $134,000 (up $114,000 or 570.0%) compared to $20,000 in 2018. The primary reason for the increase in OREO related expense was due to the $111,000 write-down of the Company's lone remaining property in 2019 after receipt of an updated property valuation report. Operating expenses on the properties in 2019 totaled $23,000 compared to $16,000 in 2018. Write-downs on the property totaled $4,000 in 2018. At December 31, 2019, the Company held one property with a book value of $846,000.

The total OREO expense in 2018 was $20,000 (down $24,000 or 54.5%) compared to $44,000 in 2017. The primary reason for the decrease in OREO related expenses was due to the sale of one of the properties in the third quarter of 2017. Operating expenses on the properties held in 2017 totaled $52,000 compared to $16,000 in 2018. In 2017, the gains on sale, which offset the overall OREO expense, were $8,000 compared to zero in 2018. There were no write-downs on any of the properties held during 2017 compared to write-downs of $4,000 in 2018. At December 31, 2018, the Company held one property with a book value of $957,000.

Occupancy, Furniture and Equipment

Occupancy expense decreased $27,000 (2.6%) during 2019 to $1,023,000, compared to $1,050,000 in 2018. Furniture and equipment expense decreased $11,000 (2.0%) during 2019 to $542,000 compared to $553,000 in 2018. The decrease in occupancy and furniture and equipment expense decrease resulted from lower depreciation expense on premises and equipment leased or owned by the Company.

Occupancy expense decreased $3,000 (0.3%) during 2018 to $1,050,000, compared to $1,053,000 in 2017. Furniture and equipment expense decreased $33,000 (5.6%) during 2018 to $553,000 compared to $586,000 in 2017. The decrease in occupancy and furniture and equipment expense decrease resulted from lower depreciation expense on premises and equipment leased or owned by the Company.

Regulatory Assessments

Regulatory assessments include fees paid to the California Department of Business Oversight (the "DBO") and the Federal Deposit Insurance Corporation (the "FDIC"). FDIC assessments decreased $154,000 (76.2%) during 2019 to $48,000, compared to $202,000 in 2018. The assessments paid to the DBO in 2019 were $78,000, compared to an expense of $78,000 in 2018. The decrease in FDIC assessments in 2019 is due to the receipt of the FDIC's Small Bank Assessment Credits during the year as the Deposit Insurance Fund Reserve Ratio exceeded 1.35%.

FDIC assessments decreased $4,000 (1.9%) during 2018 to $202,000, compared to $206,000 in 2017. The assessments paid to the DBO in 2018 were $78,000, compared to an expense of $74,000 in 2017.

Other Expenses

Table Five below provides a summary of the components of the other noninterest expenses for the periods indicated (dollars in thousands):

	Year Ended December 31,		
	2019	2018	2017
Professional fees	$ 1,226	$ 1,158	$ 1,140
Outsourced item processing	322	315	319
Directors' expense	518	514	427
Telephone and postage	328	409	360
Stationery and supplies	138	140	135
Advertising and promotion	599	561	228
Other operating expenses	574	307	557
	$ 3,705	$ 3,404	$ 3,166

Other expenses were $3,705,000 (up $301,000 or 8.8%) for 2019, compared to $3,404,000 for 2018. The increase in other expenses occurred primarily in the professional fees (up $68,000) and bank charges (up $233,000) (which is included in the other operating expenses line item). The increase in professional expenses is related to more services being provided by the Company's network administrator. The higher bank charges relate to lower average balances maintained by the Company in these accounts in 2019 resulting in higher service charges and the interest earned on these balances began to increase in 2018 due to the higher interest rate environment and continued into 2019, as a result, in 2019 the Company began being recording this as interest income on deposits held in other banks. Partially offsetting these increases was a reduction in telephone expense which decreased $91,000 (26.6%) from $342,000 in 2018 to $251,000 in 2019 and relates to the Company converted to a more cost-effective telephone system. The overhead efficiency ratio on a taxable equivalent basis for 2019 was 67.1% compared to 69.4% in 2018.

Other expenses were $3,404,000 (up $238,000 or 7.5%) for 2018, compared to $3,166,000 for 2017. The increase in other expenses occurred primarily in the advertising and promotion expense category. Advertising and promotion expense increased $333,000 (146.1%), from $228,000 in 2017 to $561,000 in 2018. Much of this increase is related to the expenses to sponsor community events and other promotional activities as the Company is focusing more effort in our markets to strengthen our brand. The overhead efficiency ratio on a taxable equivalent basis for 2018 was 69.4% compared to 65.8% in 2017.

Provision for Income Taxes

The effective tax rate on income was 25.6%, 24.3%, and 50.4% in 2019, 2018 and 2017, respectively. The effective tax rate differs from the federal statutory tax rate due to state tax expense (net of federal tax effect) of $610,000, $523,000, and $420,000 in these years. Tax-exempt income of $1,361,000, $1,315,000, and $1,471,000 from investment securities, loans, and bank-owned life insurance in these years helped to reduce the effective tax rate. The higher effective tax rate in 2019 compared 2018 is related to the tax treatment of equity based compensation under Accounting Standards Update 2016-09 ("ASU 2016-09"). Under ASU 2016-09, if the market value of the Company's stock price on the date restricted stock vests is higher than the Company's stock price on the date the restricted stock was awarded the Company receives a tax credit for the difference in values and if the market price on the vesting date is lower than the stock price on the award date the Company recognizes additional tax expense. During 2018, the Company recognized a $166,000 tax credit under ASU 2016-09 and in 2019 the Company recognized a $34,000 tax credit under ASU 2016-09.

The lower effective tax rate in 2018 compared to 2017 results from the lower corporate federal income tax rate of 21% effective January 1, 2018, which was a reduction from the Company's 2017 rate of 34%. The high effective tax rate in 2017 resulted from the Company recording an income tax expense adjustment of $1,220,000 related to "H.R.1" commonly referred to as the Tax Cuts and Jobs Act that was signed into law on December 22, 2017. The adjustment relates to revaluing the Company's net deferred tax assets using the new lower corporate federal income tax rate of 21%.

The Company's taxable income in 2018 was $6,474,000 up slightly from $6,450,000 in 2017, however, the combined federal and State income tax expense decreased $1,678,000 (51.6%) from $3,252,000 in 2017 to $1,574,000 in 2018. Excluding the $1,220,000 adjustment related to H.R.1, the tax expense would have been $2,032,000 in 2017. Comparing the actual expense of $1,574,000 in 2018 to the adjusted expense of $2,032,000 in 2017 points out the benefit of the lower 21% federal tax rate.

Balance Sheet Analysis

The Company's total assets were $720,353,000 at December 31, 2019 compared to $688,092,000 at December 31, 2018, representing an increase of $32,261,000 (4.7%). The average balances of total assets during 2019 were $703,205,000, up $21,575,000 or 3.2% from the 2018 average balances of total assets of $681,630,000.

Investment Securities

The Company classifies its investment securities as trading, held-to-maturity or available-for-sale. The Company's intent is to hold all securities classified as held-to-maturity until maturity and management believes that it has the ability to do so. Securities classified as available-for-sale may be sold to implement asset/liability management strategies as part of our contingency funding plan and in response to changes in interest rates, prepayment rates and similar factors. Table Six below summarizes the values of the Company's investment securities held on December 31 of the years indicated. The Company did not have any investment securities classified as trading in any of the years indicated below.

Table Six: Investment Securities Composition
(dollars in thousands)

Available-for-sale (at fair value)	2019	2018	2017
Debt securities:			
US Government Agencies and US Government-Sponsored Agencies	$ 241,887	$ 269,049	$ 232,869
Obligations of states and political subdivisions	13,447	14,400	22,715
Corporate debt securities	6,631	6,508	6,626
U. S Treasury securities	-	4,976	-
Equity securities:			
Corporate stock	-	-	112
Total available-for-sale investment securities	$ 261,965	$ 294,933	$ 262,322

Held-to-maturity (at amortized cost)			
Debt securities:			
US Government Agencies and US Government-Sponsored Agencies	$ 248	$ 292	$ 378
Total held-to-maturity investment securities	$ 248	$ 292	$ 378

Net unrealized gains on available-for-sale investment securities totaling $2,554,000 were recorded, net of $752,000 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2019 and net unrealized losses on available-for-sale investment securities totaling $2,664,000 were recorded, net of $788,000 in tax assets, as accumulated other comprehensive income within shareholders' equity at December 31, 2018. Management periodically evaluates each investment security in a loss position for other than temporary impairment relying primarily on industry analyst reports, observation of market conditions and interest rate fluctuations. Management has the ability and intent to hold securities with established maturity dates until recovery of fair value, which may be until maturity, and believes it will be able to collect all amounts due according to the contractual terms for all of the underlying investment securities; therefore, management does not consider these investments to be other-than-temporarily impaired. See Table Fifteen, "Securities Maturities and Weighted Average Yields," for a breakdown of the investment securities by maturity and the corresponding weighted average yields.

Loans and Leases

The Company concentrates its lending activities in the following principal areas: (1) commercial; (2) commercial real estate; (3) multi-family real estate; (4) real estate construction (both commercial and residential); (5) residential real estate; (6) lease financing receivable; (7) agriculture; and (8) consumer loans. At December 31, 2019, these categories accounted for approximately 11%, 54%, 14%, 6%, 7%, 0%, 2% and 6%, respectively, of the Company's loan portfolio compared to approximately 9%, 62%, 18%, 2%, 5%, 0%, 1% and 3%, respectively, at December 31, 2018. Also, as noted in Table 7 below, the Company's primary focus is commercial and real estate loans, however, in 2018 the Company was selected by a lender that specializes in classic and collector cars. The company began purchasing loans from this lender during the third quarter of 2018 and recorded $10,791,000 during 2018 and $20,960,000 during 2019 and accounts for the increase in consumer loans.

Continuing focus in the Company's market area, new borrowers developed through the Company's marketing efforts, an upgraded lending team in 2018, and credit extensions expanded to existing borrowers resulted in the Company originating approximately $149 million in loans in 2019 and $104 million in 2018 compared to $30 million in 2017. This production was offset by normal pay downs and payoffs, and resulted in an overall net increase in net loans and leases of $75.3 million (23.6%) from December 31, 2018. The market in which the Company operates has shown increased demand for credit products as the relatively low rate environment and expectations for economic expansion have increased refinancing as well as new loan activity. Table Seven below summarizes the composition of the loan and lease portfolio for the past five years as of December 31.

Table Seven: Loan and Lease Portfolio Composition

	December 31,				
(dollars in thousands)	2019	2018	2017	2016	2015
Commercial	$ 43,019	$ 29,650	$ 25,377	$ 35,374	$ 36,195
Real estate:					
Commercial	214,604	199,894	185,452	191,129	199,591
Multi-family	56,818	56,139	78,025	73,373	23,494
Construction	23,169	5,685	5,863	9,180	14,533
Residential	29,180	16,338	15,813	15,718	14,200
Lease financing receivable	-	32	205	404	732
Agriculture	6,479	4,419	1,713	2,302	2,431
Consumer	25,671	10,714	945	1,650	3,122
	398,940	322,871	313,393	329,130	294,298
Deferred loan fees and costs, net	-	37	(202)	(222)	(221)
Allowance for loan and lease losses	(5,138)	(4,392)	(4,478)	(4,822)	(4,975)
Total net loans and leases	$ 393,802	$ 318,516	$ 308,713	$ 324,086	$ 289,102

A significant portion of the Company's loans and leases are direct loans and leases made to individuals and local businesses. The Company relies substantially on networking, local promotional activity, and personal contacts by American River Bank officers, directors and employees to compete with other financial institutions. The Company makes loans and leases to borrowers whose applications include a sound purpose and a viable primary repayment source, generally supported by a secondary source of repayment.

Commercial loans consist of credit lines for operating needs, loans for equipment purchases, working capital, and various other business loan products. Consumer loans include a range of traditional consumer loan products such as personal lines of credit and homeowner equity lines of credit and loans to finance purchases of autos (including classic and collector's autos), boats, recreational vehicles, mobile homes and various other consumer items. Construction loans are generally comprised of commitments to customers within the Company's service area for construction of commercial properties, multi-family properties and custom and semi-custom single-family residences. Other real estate loans consist primarily of loans secured by first trust deeds on commercial, multi-family, and residential properties typically with maturities from 3 to 10 years and original loan-to-value ratios generally from 65% to 75%. Agriculture loans consist primarily of loans secured by real property. In general, except in the case of loans under SBA programs or Farm Services Agency guarantees, the Company does not make long-term mortgage loans.

Average loans and leases in 2019 were $359,329,000, which represents an increase of $50,964,000 (16.5%) compared to the average in 2018. Average loans and leases in 2018 were $308,365,000, which represents a decrease of $11,266,000 (3.5%) compared to the $319,631,000 average balance in 2017.

Risk Elements

The Company assesses and manages credit risk on an ongoing basis through a total credit culture that emphasizes excellent credit quality, extensive internal monitoring and established formal lending policies. Additionally, the Company contracts with an outside loan review consultant to periodically review the existing loan and lease portfolio. Management believes its ability to identify and assess risk and return characteristics of the Company's loan and lease portfolio is critical for profitability and growth. Management strives to continue its emphasis on credit quality in the loan and lease approval process, through active credit administration and regular monitoring. With this in mind, management has designed and implemented a comprehensive loan and lease review and grading system that functions to continually assess the credit risk inherent in the loan and lease portfolio.

Ultimately, underlying trends in economic and business cycles influence credit quality. American River Bank's business is concentrated in the Sacramento Metropolitan Statistical Area, which is a diversified economy, but with a large State of California government presence and employment base; in Sonoma County, which is focused on businesses within the two communities in which the Bank has offices (Santa Rosa and Healdsburg); and in Amador County, in which the Bank is primarily focused on businesses within the three communities in which it has offices (Jackson, Pioneer, and Ione). The economy of Sonoma County is diversified with professional services, manufacturing, agriculture and real estate investment and construction, while the economy of Amador County is reliant upon government, services, retail trade, manufacturing industries and Indian gaming.

The Company has significant extensions of credit and commitments to extend credit that are secured by real estate. The ultimate repayment of these loans is generally dependent on personal or business cash flows or the sale or refinancing of the real estate. The Company monitors the effects of current and expected market conditions and other factors on the collectability of real estate loans. The more significant factors management considers involve the following: lease rates and terms, vacancy rates, absorption and sale rates and capitalization rates; real estate values, supply and demand factors, and rates of return; operating expenses; inflation and deflation; and sufficiency of repayment sources independent of the real estate including, in some instances, personal guarantees.

In extending credit and commitments to borrowers, the Company generally requires collateral and/or guarantees as security. The repayment of such loans is expected to come from cash flows or from proceeds from the sale of selected assets of the borrowers. The Company's requirement for collateral and/or guarantees is determined on a case-by-case basis in connection with management's evaluation of the creditworthiness of the borrower. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, income-producing properties, residences and other real property. The Company secures its collateral by perfecting its security interest in business assets, obtaining deeds of trust, or outright possession among other means.

In management's judgment, a concentration exists in real estate loans which represented approximately 81% of the Company's loan and lease portfolio at December 31, 2019 and 87% at December 31, 2018. Management believes that the residential land portion of the Company's loan portfolio carries a reasonable level of credit risk. As of December 31, 2019, outstanding unimproved residential land commitments were $6,184,000 (or just 1.9% of the total real estate loans). Of the $6,184,000, $1,997,000 (32%) was represented by one amortizing loan, which was considered well-secured, with a favorable loan-to-value ratio. Management currently believes that it maintains its allowance for loan and lease losses at levels adequate to reflect the loss risk inherent in its total loan portfolio.

A decline in the economy in general, or decline in real estate values in the Company's market areas, in particular, could have an adverse impact on the collectability of real estate loans and require an increase in the provision for loan and lease losses. This could adversely affect the Company's future prospects, results of operations, profitability and stock price. Management believes that its lending practices and underwriting standards are structured with the intent to minimize losses; however, there is no assurance that losses will not occur. The Company's loan practices and underwriting standards include, but are not limited to, the following: (1) maintaining a thorough understanding of the Company's market area and originating a significant majority of its loans within that area, (2) maintaining a thorough understanding of borrowers' knowledge, capacity, and market position in their field of expertise, (3) basing real estate loan approvals not only on market demand for the project, but also on the borrowers' capacity to support the project financially in the event it does not perform to expectations (whether sale or income performance), and (4) maintaining conforming and prudent loan-to-value and loan-to-cost ratios based on independent outside appraisals and ongoing inspection and analysis by the Company's lending officers or contracted third-party professionals.

Nonaccrual, Past Due and Restructured Loans and Leases

Management places loans and leases on nonaccrual status when they become 90 days past due or if a loss is expected, unless the loan or lease is well secured and in the process of collection. Loans and leases are partially or fully charged off when, in the opinion of management, collection of such amount appears unlikely.

The recorded investments in nonperforming loans and leases, which includes nonaccrual loans and leases and loans and leases that were 90 days or more past due and on accrual, totaled zero and $27,000 at December 31, 2019 and 2018, respectively. The $27,000 in nonperforming loans and leases at December 31, 2018 were comprised of one commercial loan relationship with two loans totaling $27,000, both of which were current to terms. At December 31, 2019 there were two loans totaling $75,000 30 days or more past due compared to no loans that were 30 days or more past due December 31, 2018.

Restructured loans considered performing and accruing at December 31, 2019, 2018, 2017, 2016 and 2015, were $5,970,000, $6,626,000, $6,799,000, $7,975,000, and $8,062,000, respectively. Table Eight below sets forth nonaccrual loans and leases and loans and leases past due 90 days or more and on accrual as of year-end for the past five years.

Table Eight: Nonperforming Loans and Leases

	December 31,				
(dollars in thousands)	2019	2018	2017	2016	2015
Past due 90 days or more and still accruing:					
Commercial	$ -	$ -	$ -	$ -	$ -
Real estate	-	-	-	-	-
Lease financing receivable	-	-	-	-	-
Consumer and other	-	-	-	-	-
Nonaccrual:					
Commercial	-	27	1,597	-	30
Real estate	-	-	289	-	1,493
Lease financing receivable	-	-	-	-	-
Consumer and other	-	-	6	19	120
Total nonperforming loans and leases	$ -	$ 27	$ 1,892	$ 19	$ 1,643

Interest income recognized from payments received on nonaccrual loans and leases was approximately $1,000 in 2019, $43,000 in 2018 and $2,000 in 2017. There were no loan or lease concentrations in excess of 10% of total loans and leases not otherwise disclosed as a category of loans and leases as of December 31, 2019. Management is not aware of any potential problem loans, which were accruing and current at December 31, 2019, where serious doubt exists as to the ability of the borrower to comply with the present repayment terms and that would result in a significant loss to the Company apart from those loans identified in the Bank's impairment analysis.

Management monitors the Company's performance metrics including the ratios related to nonperforming loans and leases. From 2008 to 2010, the Company experienced an increase in nonperforming loans and leases. In 2011, the focused efforts of the previous years resulted in a decrease in these levels. From 2012 to 2019, the level of nonperforming loans and leases continued to decrease to a level below the amount reported at December 31, 2008. However, the variations in the amount of nonperforming loans and leases does not directly impact the level of the Company's allowance for loan and lease losses as management monitors each of the loans and leases for loss potential or probability of loss on an individual basis using accounting principles generally accepted in the United States of America.

Impaired Loans and Leases

The Company considers a loan to be impaired when, based on current information and events, it is probable that it will be unable to collect all amounts due (principal and interest) according to the original contractual terms of the loan or lease agreement. The measurement of impairment may be based on (i) the present value of the expected cash flows of the impaired loan or lease discounted at the loan's or lease's original effective interest rate, (ii) the observable market price of the impaired loan or lease, or (iii) the fair value of the collateral of a collateral-dependent loan. The Company does not apply this definition to smaller-balance loans or leases that are collectively evaluated for credit risk. In assessing whether a loan or lease is impaired, the Company typically reviews loans or leases graded substandard or lower with outstanding principal balances in excess of $100,000, as well as loans considered troubled debt restructures with outstanding principal balances in excess of $25,000. The Company identifies troubled debt restructures by reviewing each renewal, modification, or extension of a loan with a screening document. This document is designed to identify any characteristics of such a loan that would qualify it as a troubled debt restructure. If the characteristics are not present that would qualify a loan as a troubled debt restructure, it is deemed to be a modification.

The recorded investment in loans and leases that were considered to be impaired totaled $7,604,000 at December 31, 2019 and had a related valuation allowance of $142,000. The average recorded investment in impaired loans and leases during 2019 was approximately $7,845,000. As of December 31, 2018, the recorded investment in loans and leases that were considered to be impaired totaled $8,702,000 and had a related valuation allowance of $185,000. The average recorded investment in impaired loans and leases during 2018 was approximately $8,847,000. As of December 31, 2017, the recorded investment in loans and leases that were considered to be impaired totaled $13,757,000 and had a related valuation allowance of $355,000. The average recorded investment in impaired loans and leases during 2017 was approximately $14,046,000.

Allowance for Loan and Lease Losses Activity

The Company maintains an allowance for loan and lease losses ("ALLL") to cover probable losses inherent in the loan and lease portfolio, which is based upon management's estimate of those losses. The ALLL is established through a provision for loan and lease losses and is increased by provisions charged against current earnings and recoveries and reduced by charge-offs. Actual losses for loans and leases can vary significantly from this estimate. The methodology and assumptions used to calculate the allowance are continually reviewed as to their appropriateness given the most recent losses realized and other factors that influence the estimation process. The model assumptions and resulting allowance level are adjusted accordingly as these factors change.

The adequacy of the ALLL and the level of the related provision for loan and lease losses is determined based on management's judgment after consideration of numerous factors including, but not limited to: (i) local and regional economic conditions, (ii) the financial condition of the borrowers, (iii) loan impairment and the related level of expected charge-offs, (iv) evaluation of industry trends, (v) industry and other concentrations, (vi) loans and leases which are contractually current as to payment terms but demonstrate a higher degree of risk as identified by management, (vii) continuing evaluations of the performing loan portfolio, (viii) ongoing review and evaluation of problem loans identified as having loss potential, (ix) quarterly review by the Board of Directors, and (x) assessments by banking regulators and other third parties. Management and the Board of Directors evaluate the ALLL and determine its appropriate level considering objective and subjective measures, such as knowledge of the borrower's business, valuation of collateral, the determination of impaired loans or leases and exposure to potential losses.

The ALLL totaled $5,138,000 or 1.29% of total loans and leases at December 31, 2019, $4,392,000 or 1.36% of total loans and leases at December 31, 2018, and $4,478,000 or 1.43% at December 31, 2017. The increase in the allowance for loan and lease losses from $4,392,000 at December 31, 2018 to $5,138,000 at December 31, 2019, was mainly due to the increase in loans outstanding at December 31, 2019. The Company establishes general and specific reserves in accordance with accounting principles generally accepted in the United States of America. The ALLL is composed of categories of the loan and lease portfolio based on loan type and loan rating; however, the entire allowance is available to cover actual loan and lease losses. While management uses available information to recognize possible losses on loans and leases, future additions to the allowance may be necessary, based on changes in economic conditions and other matters. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's ALLL. Such agencies may require the Company to provide additions to the allowance based on their judgment of information available to them at the time of their examination.

The allowance for loans and leases as a percentage of impaired loans and leases was 67.6% at December 31, 2019 and 50.5% at December 31, 2018. Of the total nonperforming and impaired loans and leases outstanding as of December 31, 2019, there were $794,000 in loans or leases that had been reduced by partial charge-offs of $292,000.

At December 31, 2019, there was $5,848,000 in impaired loans or leases that did not carry a specific reserve. Of this amount, $477,000 were loans or leases that had previous partial charge-offs and $5,371,000 were loans or leases that were analyzed and determined not to require a specific reserve or charge-off because the collateral value or discounted cash flow value exceeded the loan or lease balance. Prior to 2013, the Company had been operating in a market that had experienced significant decreases in real estate values of commercial, residential, land, and construction properties. As such, the Company continues to focus on monitoring collateral values for those loans considered collateral dependent. The collateral evaluations performed by the Company are updated as necessary, which is generally once every twelve months, and are reviewed by a qualified credit officer.

The Company's policy with regard to loan or lease charge-offs continues to be that a loan or lease is charged off against the ALLL when management believes that the collectability of the principal is unlikely. As previously discussed in the "Impaired Loans and Leases" section, certain loans are evaluated for impairment. Generally, if a loan is collateralized by real estate, and considered collateral dependent, the impaired portion will be charged off to the allowance for loan and lease losses unless it is in the process of collection, in which case a specific reserve may be warranted. If the collateral is other than real estate and considered impaired, a specific reserve may be warranted.

It is the policy of management to maintain the allowance for loan and lease losses at a level believed to be adequate for known and inherent risks in the portfolio. 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. Formula allocations are calculated by applying historical loss factors to outstanding loans with similar characteristics. Historical loss factors are based upon the Company's loss experience. These historical loss factors are adjusted for changes in the business cycle and for significant factors that, in management's judgment, affect the collectability of the loan portfolio as of the evaluation date. The discretionary allocation is based upon management's evaluation of various loan segment conditions that are not directly measured in the determination of the formula and specific allowances. The conditions may include, but are not limited to, general economic and business conditions affecting the key lending areas of the Company, credit quality trends, collateral values, loan volumes and concentrations, and other business conditions. Based on information currently available, management believes that the allowance for loan and lease losses is prudent and adequate. However, no prediction of the ultimate level of loans and leases charged off in future periods can be made with any certainty. Table Nine below summarizes, for the periods indicated, the activity in the ALLL.

Table Nine: Allowance for Loan and Lease Losses
(dollars in thousands)

	Year Ended December 31,				
	2019	2018	2017	2016	2015
Average loans and leases outstanding	$ 359,329	$ 308,365	$ 319,631	$ 306,737	$ 279,728
Allowance for loan & lease losses at beginning of period	$ 4,392	$ 4,478	$ 4,822	$ 4,975	$ 5,301
Loans and leases charged off:					
Commercial	-	213	1,073	-	609
Real estate	-	-	-	93	-
Consumer	-	69	-	34	6
Lease financing receivable	-	-	-	-	1
Total	-	282	1,073	127	616
Recoveries of loans and leases previously charged off:					
Commercial	7	12	6	660	123
Real estate	11	8	228	534	165
Consumer	68	-	4	124	2
Lease financing receivable	-	1	41	-	-
Total	86	21	279	1,318	290
Net loans and leases (recovered) charged off	(86)	261	794	(1,191)	326
Additions (reductions) to allowance charged (credited) to operating expenses	660	175	450	(1,344)	-
Allowance for loan and lease losses at end of period	$ 5,138	$ 4,392	$ 4,478	$ 4,822	$ 4,975
Ratio of net (recoveries) charge-offs to average loans and leases outstanding	(0.02%)	0.08%	0.25%	(0.39%)	0.12%
Provision for loan and lease losses to average loans and leases outstanding	0.18%	0.06%	0.14%	(0.44%)	-
Allowance for loan and lease losses to total loans and leases, at end of period	1.29%	1.36%	1.43%	1.47%	1.69%
Allowance for loan and lease losses to nonperforming loans and leases, at end of period	N/A	16,266.67%	236.68%	25,378.95%	302.80%

As part of its loan review process, management has allocated the overall allowance based on specific identified problem loans and leases, qualitative factors, uncertainty inherent in the estimation process and historical loss data. A risk exists that future losses cannot be precisely quantified or attributed to particular loans or leases or classes of loans and leases. Management continues to evaluate the loan and lease portfolio and assesses current economic conditions that will affect management's conclusion as to future allowance levels. Table Ten below summarizes the allocation of the allowance for loan and lease losses for the five years ended December 31, 2019.

Table Ten: Allowance for Loan and Lease Losses by Loan Category

(dollars in thousands)

	December 31, 2019		December 31, 2018		December 31, 2017	
	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans
Commercial	$ 950	11%	$ 668	9%	$ 447	8%
Real estate	3,502	81%	3,165	87%	3,695	91%
Agriculture	107	2%	88	1%	31	1%
Consumer	334	6%	192	3%	14	--
Lease financing receivable	-	--	-	--	-	--
Unallocated	245	--	279	--	291	--
Total	$ 5,138	100%	$ 4,392	100%	$ 4,478	100%

	December 31, 2016		December 31, 2015	
	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans
Commercial	$ 855	12%	$ 860	12%
Real estate	3,600	86%	3,729	86%
Agriculture	64	1%	77	1%
Consumer	24	1%	78	1%
Lease financing receivable	1	--	1	--
Unallocated	278	--	230	--
Total	$ 4,822	100%	$ 4,975	100%

The allocation presented should not be interpreted as an indication that charges to the allowance for loan and lease losses will be incurred in these amounts or proportions, or that the portion of the allowance allocated to each loan and lease category represents the total amounts available for charge-offs that may occur within these categories.

Other Real Estate Owned and Repossessed Assets

The balance in OREO at December 31, 2019 and 2018 consisted of one property acquired through foreclosure. During 2018, the Company received an updated appraisal on the one property and reduced the balance by $4,000 through a charge to OREO expense. During 2019, the Company received an updated appraisal on the one property and reduced the balance by an additional $111,000 through a charge to OREO expense. During 2019, the Company did not acquire any OREO properties. There was $846,000 in OREO at December 31, 2019 with no valuation allowance and $957,000 in OREO at December 31, 2018 with no valuation allowance. During 2019, the Company took possession of an automobile formerly held as collateral on a loan. The book value of the automobile at December 31, 2019 was $517,000. Other than the $517,000 automobile, there were no other asset repossessed during 2019 or 2018.

Deposits

At December 31, 2019, total deposits were $604,837,000 representing an increase of $14,163,000 (2.4%) from the December 31, 2018 balance of $590,674,000. The Company's deposit growth plan for 2019 was to concentrate its efforts on increasing noninterest-bearing demand, interest-bearing money market and interest-bearing checking, and savings accounts, while continuing to focus on reducing overall interest expense. Due to these efforts, the Company experienced an increase in non-time deposits (CD's) balances of $28,441,000 (5.7%) from $502,587,000 at December 31, 2018 to $531,028,000 at December 31, 2019. During 2019 the Company had increased balances in noninterest-bearing checking ($12,310,000 or 5.7%), money market ($12,488,000 or 8.6%), savings ($3,298,000 or 4.5%), and interest checking ($345,000 or 0.5%) and a decrease in time deposit ($14,278,000 or 16.2%).

Other Borrowed Funds

Other borrowings outstanding as of December 31, 2019 consist of advances from the Federal Home Loan Bank (the "FHLB"). The following table summarizes these borrowings (dollars in thousands):

	2019		2018		2017	
	Amount	Rate	Amount	Rate	Amount	Rate
Short-term borrowings:						
FHLB advances	$ 9,000	1.46%	$ 5,000	1.32%	$ 3,500	1.39%
Long-term borrowings:						
FHLB advances	$ 10,500	2.48%	$ 10,500	2.02%	$ 12,000	1.41%

The maximum amount of short-term borrowings at any month-end during 2019, 2018 and 2017, was $16,000,000, $6,500,000, and $3,500,000, respectively. The FHLB advances are collateralized by loans and securities pledged to the FHLB. The following is a breakdown of rates and maturities on FHLB advances (dollars in thousands):

	Short-term	Long-term
Amount	$ 9,000	$ 10,500
Maturity	2020	2021 to 2023
Average rates	1.46%	2.48%

The Company has the ability to enter into letters of credit with the FHLB. There were no letters of credit outstanding as of December 31, 2019 or 2018. There were no amounts drawn upon any letter of credit in 2019 or 2018 and management does not expect to draw upon these sources of liquidity in the foreseeable future.

Capital Resources

The current and projected capital position of the Company and the impact of capital plans and long-term strategies are reviewed regularly by management. The Company's capital position represents the level of capital available to support continuing operations and expansion.

On January 24, 2018, the Company approved and authorized a stock repurchase program for 2018 (the "2018 Program"). The 2018 Program authorized the repurchase during 2018 of up to 5% of the outstanding shares of the Company's common stock. During 2018, the Company repurchased 308,618 shares of its common stock at an average price of $15.52 per share. The Company did not have a repurchase program in 2019 and therefore did not repurchase any shares in 2019.

The Company repurchased 575,389 shares in 2012, 849,404 shares in 2013, 424,462 in 2014, 790,989 shares in 2015, 716,897 shares in 2016, and 574,748 shares in 2017. Share amounts have been adjusted for stock dividends and/or splits. See Part II, Item 5, "Stock Repurchases" for more information regarding stock repurchases.

The Company and American River Bank are subject to certain regulatory capital requirements administered by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation. Failure to meet these minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, banks must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and American River Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. As of December 31, 2019 and 2018, the most recent regulatory notification categorized American River Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's categories.

At December 31, 2019, shareholders' equity was $82,909,000, representing an increase of $8,188,000 (11.0%) from $74,721,000 at December 31, 2018. The increase in 2019 resulted from additions of net income of $5,500,000, the increase in the unrealized gain on securities due to a decrease in interest rates of $3,668,000, and stock based compensation of $433,000 exceeding the payment of cash dividends of $1,413,000. In 2018, shareholders' equity decreased $2,200,000 (2.9%) from $76,921,000 at December 31, 2017. The decrease in 2018 resulted from repurchases of common stock of $4,773,000, the payment of cash dividends of $1,188,000, and a decrease in other comprehensive income of $1,555,000, as a result of the decrease in the unrealized gain on securities due to an increase in interest rates, exceeding the additions from net income of $4,900,000 for the period and the stock based compensation of $416,000.

Table Eleven below lists the Company's and American River Bank's actual capital ratios at December 31, 2019 and 2018, as well as the minimum capital ratios for capital adequacy for American River Bank. The ratio for the minimum regulatory requirement includes the capital conservation buffer of 2.50% as of December 31, 2019 and 1.875% as of December 31, 2018.

Table Eleven: Capital Ratios

	At December 31,		Minimum Regulatory Capital Requirements	
	2019	2018	2019	2018
American River Bankshares:				
Leverage ratio	9.2%	8.9%	N/A	N/A
Tier 1 Risk-Based Capital	14.8%	16.1%	N/A	N/A
Total Risk-Based Capital	15.9%	17.3%	N/A	N/A
American River Bank:				
Leverage ratio	9.3%	9.0%	6.5%	5.9%
Common Equity Tier 1 Capital	14.9%	16.2%	7.0%	6.4%
Tier 1 Risk-Based Capital	14.9%	16.2%	8.5%	7.9%
Total Risk-Based Capital	16.1%	17.4%	10.5%	9.9%

Capital ratios are reviewed on a regular basis to ensure that capital exceeds the prescribed regulatory minimums and is adequate to meet future needs. At December 31, 2019, American River Bank's ratios were in excess of the regulatory definition of "well capitalized." Management believes that the Company's capital is adequate to support current operations and anticipated growth and currently foreseeable future capital requirements of the Company and its subsidiaries.

Effective January 1, 2015, bank holding companies with consolidated assets of $1 Billion or more ($3 Billion or more effective August 30, 2018) and banks like American River Bank must comply with new minimum capital ratio requirements to be phased-in between January 1, 2015 and January 1, 2019, which consist of the following: (i) a new common equity Tier 1 capital to total risk weighted assets ratio of 4.5%; (ii) a Tier 1 capital to total risk weighted assets ratio of 6%; (iii) a total capital to total risk weighted assets ratio of 8%; and (iv) a Tier 1 capital to adjusted average total assets ("leverage") ratio of 4%.

In addition, a "capital conservation buffer," was established and has been fully phased-in as of January 1, 2019 and requires maintenance of a minimum of 2.5% of common equity Tier 1 capital to total risk weighted assets in excess of the regulatory minimum capital ratio requirements described above. The 2.5% buffer increases the minimum capital ratios to (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. The buffer requirement was phased-in between January 1, 2016 and January 1, 2019. If the capital ratio levels of a banking organization fall below the capital conservation buffer amount, the organization will be subject to limitations on (i) the payment of dividends; (ii) discretionary bonus payments; (iii) discretionary payments under Tier 1 instruments; and (iv) engaging in share repurchases.

Market Risk Management

Overview. Market risk is the risk of loss from adverse changes in market prices and rates. The Company's market risk arises primarily from interest rate risk inherent in its loan, investment and deposit functions. The goal for managing the assets and liabilities of the Company is to maximize shareholder value and earnings while maintaining a high quality balance sheet without exposing the Company to undue interest rate risk. The Board of Directors has overall responsibility for the interest rate risk management policies. The Company has an Enterprise Risk

Management Committee, made up of Company management that establishes and monitors guidelines to control the sensitivity of earnings to changes in interest rates.

Asset/Liability Management. Activities involved in asset/liability management include but are not limited to lending, accepting and placing deposits and investing in securities. Interest rate risk is the primary market risk associated with asset/liability management. Sensitivity of earnings to interest rate changes arises when yields on assets change in a different time period or in a different amount from that of interest costs on liabilities. To mitigate interest rate risk, the structure of the balance sheet is managed with the goal that movements of interest rates on assets and liabilities are correlated and contribute to earnings even in periods of volatile interest rates. The asset/liability management policy sets limits on the acceptable amount of variance in net interest margin and market value of equity under changing interest environments. The Company uses simulation models to forecast earnings, net interest margin and market value of equity.

Simulation of earnings is the primary tool used to measure the sensitivity of earnings to interest rate changes. Using computer-modeling techniques, with specialized software built for this specific purpose for financial institutions, the Company is able to estimate the potential impact of changing interest rates on earnings, net interest margin and market value of equity. A balance sheet is prepared using detailed inputs of actual loans, securities and interest-bearing liabilities (i.e. deposits/borrowings). The balance sheet is processed using multiple interest rate scenarios. The scenarios include a rising rate forecast, a flat rate forecast and a falling rate forecast which take place within a one-year time frame. The net interest income is measured over one-year and two-year periods assuming a gradual change in rates over the twelve-month horizon. The simulation modeling attempts to estimate changes in the Company's net interest income utilizing a detailed current balance sheet. Table Twelve below summarizes the effect on net interest income (NII) of a ±100 and ±200 basis point change in interest rates as measured against a constant rate (no change) scenario.

Table Twelve: Interest Rate Risk Simulation of Net Interest as of December 31, 2019

(dollars in thousands)	$ Change in NII from Current 12 Month Horizon	$ Change in NII from Current 24 Month Horizon
Variation from a constant rate scenario		
+100bp	$ 370	$ 1,172
+200bp	$ 686	$ 2,097
-100bp	$ (318)	$ (1,411)
-200bp	$ (788)	$ (3,642)

After a review of the model results as of December 31, 2019, the Company does not consider the fluctuations from the base case, to have a material impact on the Company's projected results and are within the tolerance levels outlined in the Company's interest rate risk polices. The simulations of earnings do not incorporate any management actions, which might moderate the negative consequences of interest rate deviations. Therefore, they do not reflect likely actual results, but serve as reasonable estimates of interest rate risk.

Interest Rate Sensitivity Analysis

Interest rate sensitivity is a function of the repricing characteristics of the portfolio of assets and liabilities. These repricing characteristics are the time frames within which the interest-bearing assets and liabilities are subject to change in interest rates either at replacement, repricing or maturity. Interest rate sensitivity management focuses on the maturity of assets and liabilities and their repricing during periods of changes in market interest rates. Interest rate sensitivity is measured as the difference between the volumes of assets and liabilities in the current portfolio that are subject to repricing at various time horizons. The differences are known as interest sensitivity gaps. A positive cumulative gap may be equated to an asset sensitive position. An asset sensitive position in a rising interest rate environment will cause a bank's interest rate margin to expand. This results as floating or variable rate loans reprice more rapidly than fixed rate certificates of deposit that reprice as they mature over time. Conversely, a declining interest rate environment will cause the opposite effect. A negative cumulative gap may be equated to a liability sensitive position. A liability sensitive position in a rising interest rate environment will cause a bank's interest rate margin to contract, while a declining interest rate environment will have the opposite effect.

Inflation

The impact of inflation on a financial institution differs significantly from that exerted on manufacturing, or other commercial concerns, primarily because its assets and liabilities are largely monetary. In general, inflation primarily affects the Company through its effect on market rates of interest, which affects the Company's ability to attract loan customers. Inflation affects the growth of total assets by increasing the level of loan demand, and potentially adversely affects capital adequacy because loan growth in inflationary periods can increase at rates higher than the rate that capital grows through retention of earnings which may be generated in the future. In addition to its effects on interest rates, inflation increases overall operating expenses. Inflation has not had a material effect upon the results of operations of the Company during the years ended December 31, 2019, 2018 and 2017.

Liquidity

Liquidity management refers to the Company's ability to provide funds on an ongoing basis to meet fluctuations in deposit levels as well as the credit needs and requirements of its clients. Both assets and liabilities contribute to the Company's liquidity position. Federal funds lines, short-term investments and securities, and loan and lease repayments contribute to liquidity, along with deposit increases, while loan and lease funding and deposit withdrawals decrease liquidity. The Company assesses the likelihood of projected funding requirements by reviewing historical funding patterns, current and forecasted economic conditions and individual client funding needs. Commitments to fund loans and outstanding standby letters of credit at December 31, 2019 were approximately $40,324,000 and $300,000, respectively. Such loan commitments relate primarily to revolving lines of credit and other commercial loans and to real estate construction loans. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

The Company's sources of liquidity consist of cash and due from correspondent banks, overnight funds sold to correspondent banks, unpledged marketable investments and loans held for sale. On December 31, 2019, consolidated liquid assets totaled $141.5 million or 19.6% of total assets compared to $226.5 million or 32.9% of total assets on December 31, 2018. In addition to liquid assets, the Company maintains short-term lines of credit in the amount of $17,000,000 with two of its correspondent banks. At December 31, 2019, the Company had $17,000,000 available under these credit lines. Additionally, American River Bank is a member of the FHLB. At December 31, 2019, American River Bank could have arranged for up to $162,306,000 in secured borrowings from the FHLB. These borrowings are secured by pledged mortgage loans and investment securities. At December 31, 2019, the Company had $143,406,000 available under these secured borrowing arrangements. American River Bank also has a secured borrowing arrangement with the Federal Reserve Bank. The borrowing can be secured by pledging selected loans and investment securities. Based on the amount of assets pledged at the Federal Reserve Bank at December 31, 2019, the Company's borrowing capacity was $8,642,000.

The Company serves primarily a business and professional customer base and, as such, its deposit base is susceptible to economic fluctuations. Accordingly, management strives to maintain a balanced position of liquid assets to volatile and cyclical deposits.

Liquidity is also affected by portfolio maturities and the effect of interest rate fluctuations on the marketability of both assets and liabilities. The Company can sell any of its unpledged securities held in the available-for-sale category to meet liquidity needs. These securities are also available to pledge as collateral for borrowings if the need should arise. American River Bank can also pledge additional securities to borrow from the Federal Reserve Bank and the FHLB.

The maturity distribution of certificates of deposit is set forth in Table Thirteen below for the period presented. These deposits are generally more rate sensitive than other deposits and, therefore, are more likely to be withdrawn to obtain higher yields elsewhere if available.

Table Thirteen: Certificates of Deposit Maturities

December 31, 2019 (dollars in thousands)	Less than $250,000	Over $250,000
Three months or less	$ 6,900	$ 24,474
Over three months through six months	3,998	9,486
Over six months through twelve months	5,758	3,618
Over twelve months	10,935	8,640
Total	$ 27,591	$ 46,218

Loan and lease demand also affects the Company's liquidity position. Table Fourteen below presents the maturities of loans and leases for the period indicated.

Table Fourteen: Loan and Lease Maturities (Gross Loans and Leases)

December 31, 2019 (dollars in thousands)	One year or less	One year through five years	Over five years	Total
Commercial	$ 4,330	$ 13,674	$ 25,015	$ 43,019
Real estate	24,228	110,738	188,805	323,771
Agriculture	-	150	6,329	6,479
Consumer	434	591	24,646	25,671
Total	$ 28,992	$ 125,153	$ 244,795	$ 398,940

Loans and leases shown above with maturities greater than one year include $220,545,000 of variable interest rate loans and $149,403,000 of fixed interest rate loans and leases. The carrying amount, maturity distribution and weighted average yield of the Company's investment securities available-for-sale and held-to-maturity portfolios are presented in Table Fifteen below. The yields on tax-exempt obligations have been computed on a tax equivalent basis. Yields may not represent actual future income to be recorded. Timing of principal prepayments on mortgage-backed securities may increase or decrease depending on market factors and the borrowers' ability to make unscheduled principal payments. Fast prepayments on bonds that were purchased with a premium will result in a lower yield and slower prepayments on premium bonds will result in a higher yield, the opposite would be true for bonds purchased at a discount. Table Fifteen does not include FHLB Stock, which does not have stated maturity dates or readily available market values. The balance in FHLB Stock at December 31, 2019, 2018 and 2017 was $4,259,000, $3,932,000 and $3,932,000, respectively.

Table Fifteen: Securities Maturities and Weighted Average Yields

(Taxable Equivalent Basis) December 31,	2019		2018		2017	
(dollars in thousands)	Carrying Amount	Weighted Average Yield	Carrying Amount	Weighted Average Yield	Carrying Amount	Weighted Average Yield
Available-for-sale securities:						
State and political subdivisions						
Maturing within 1 year	$ -	-	$ 255	5.06%	$ -	-
Maturing after 1 year but within 5 years	952	3.70%	1,141	5.06%	3,018	2.23%
Maturing after 5 years but within 10 years	5,224	2.40%	9,831	6.03%	14,389	4.42%
Maturing after 10 years	7,271	2.81%	3,173	6.33%	5,307	4.11%
U.S. Treasury securities						
Maturing within 1 year	-	-	4,976	2.30%	-	-
U.S. Government Agencies and U.S.-Sponsored Agencies	241,887	2.69%	269,049	2.69%	232,869	2.10%
Other						
Maturing within 1 year	501	3.50%	-	-	-	-
Maturing after 1 year but within 5 years	2,003	2.24%	2,434	2.49%	2,469	2.72%
Maturing after 5 years but within 10 years	4,127	5.53%	4,074	5.53%	4,158	4.56%
Non-maturing	-	-	-	-	112	0.00%
Total investment securities	$ 261,965	2.73%	$ 294,933	2.88%	$ 262,322	2.32%
Held-to-maturity securities:						
U.S. Government Agencies and U.S.-Sponsored Agencies	$ 248	5.51%	$ 292	5.40%	$ 378	5.46%
Total investment securities	$ 248	5.51%	$ 292	5.40%	$ 378	5.46%

The carrying values of available-for-sale securities include net unrealized gains (losses) of $2,544,000, ($2,664,000) and ($456,000) at December 31, 2019, 2018 and 2017, respectively. The carrying values of held-to-maturity securities do not include unrealized gains or losses; however, the net unrecognized gains at December 31, 2019, 2018 and 2017 were $18,000, $14,000 and $26,000, respectively.

Off-Balance Sheet Arrangements

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 and to reduce its exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet.

As of December 31, 2019, commitments to extend credit and letters of credit were the only financial instruments with off-balance sheet risk. The Company has not entered into any contracts for financial derivative instruments such as futures, swaps, options or similar instruments. At origination, real estate commitments are generally secured by property with a loan-to-value ratio of 55% to 75%. In addition, the majority of the Company's commitments have variable interest rates. The following financial instruments represent off-balance-sheet credit risk:

	December 31, 2019	December 31, 2018
Commitments to extend credit (dollars in thousands):		
Revolving lines of credit secured by 1-4 family residences	$ 41	$ 47
Commercial real estate, construction and land development commitments secured by real estate	22,508	21,185
Other unused commitments, principally commercial loans	17,775	13,044
	$ 40,324	$ 34,276
Letters of credit	$ 300	$ 361

The Company's exposure to credit loss in the event of nonperformance by the other party 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 letters of credit as it does for loans included on the consolidated balance sheets.

Certain financial institutions have elected to use special purpose vehicles ("SPV") to dispose of problem assets. The SPV is typically a subsidiary company with an asset and liability structure and legal status that makes its obligations secure even if the parent corporation goes bankrupt. Under certain circumstances, these financial institutions may exclude the problem assets from their reported impaired and nonperforming assets. The Company does not use those vehicles or any other structures to dispose of problem assets.

Contractual Obligations

The Company leases certain facilities at which it conducts its operations. Future minimum lease commitments under non-cancelable operating leases are noted in Table Sixteen below. Table Sixteen below presents certain of the Company's contractual obligations as of December 31, 2019.

Table Sixteen: Contractual Obligations

(dollars in thousands)

	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-Term Debt	$ 10,500	$ -	$ 7,000	$ 3,500	$ -
Capital Lease Obligations	-	-	-	-	-
Operating Leases	3,427	769	1,446	555	657
Purchase Obligations	-	-	-	-	-
Certificates of Deposit	73,809	54,234	12,521	7,054	-
Other Long-Term Liabilities Reflected on the Company's Balance Sheet under GAAP	4,665	384	800	799	2,682
Total	$ 92,401	$ 55,387	$ 21,767	$ 11,908	$ 3,339

Included in the table are amounts payable under the Company's Deferred Compensation Plan, Deferred Fees Plan and salary continuation agreements listed in the "Other Long-Term Liabilities…" category. At December 31, 2019, these amounts represented $4,665,000 most of which is anticipated to be primarily payable at least five years in the future.

Report of Management on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting for the Company (as defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended).

The Company's management, including the Chief Executive Officer and Chief Financial Officer, has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2019, presented in conformity with accounting principles generally accepted in the United States of America. In making this assessment, management used the criteria applicable to the Company as set forth by the Committee of Sponsoring Organizations of the Treadway Commission in the 2013 *Internal Control—Integrated Framework.* Based upon such assessment, management believes that, as of December 31, 2019, the Company's internal control over financial reporting is effective based upon those criteria.

The Company's independent registered public accounting firm that audited the Company's financial statements included in this Annual Report has issued an audit report on the Company's internal control over financial reporting.

David E. Ritchie, Jr
President and Chief Executive Officer

Mitchell A. Derenzo
Executive Vice President
and Chief Financial Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Shareholders and Board of Directors
American River Bankshares
Rancho Cordova, California

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of American River Bankshares and Subsidiaries (the "Company") as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2019, and the related notes (collectively referred to as the "financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control – Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2019 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control – Integrated Framework: (2013) issued by COSO.

Basis for Opinions

The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Crowe LLP

Crowe LLP

We have served as the Company's auditor since 2011.

Sacramento, California
February 21, 2020

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 2019 and 2018
(Dollars in thousands)

	2019	2018
ASSETS		
Cash and due from banks	$ 15,258	$ 20,987
Federal funds sold	-	7,000
Interest-bearing deposits in banks	2,552	1,746
Total cash and cash equivalents	17,810	29,733
Investment securities (Note 5):		
Available-for-sale, at fair value	261,965	294,933
Held-to-maturity, at amortized cost; fair value of $266 in 2019 and $306 in 2018	248	292
Loans and leases, less allowance for loan and lease losses of $5,138 in 2019 and $4,392 in 2018 (Notes 6, 7, 12 and 17)	393,802	318,516
Premises and equipment, net (Note 8)	1,191	1,071
Federal Home Loan Bank of San Francisco stock	4,259	3,932
Other real estate owned, net	846	957
Goodwill (Note 4)	16,321	16,321
Bank-owned life insurance (Note 16)	15,763	15,429
Accrued interest receivable and other assets (Notes 11 and 16)	8,148	6,908
	$ 720,353	$ 688,092
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	$ 227,055	$ 214,745
Interest-bearing (Note 9)	377,782	375,929
Total deposits	604,837	590,674
Short-term borrowings (Note 10)	9,000	5,000
Long-term borrowings (Note 10)	10,500	10,500
Accrued interest payable and other liabilities (Note 16)	13,107	7,197
Total liabilities	637,444	613,371
Commitments and contingencies (Note 12)		
Shareholders' equity (Notes 13 and 14):		
Common stock - no par value; 20,000,000 shares authorized; issued and outstanding – 5,898,878 shares in 2019 and 5,858,428 shares in 2018	30,536	30,103
Retained earnings	50,581	46,494
Accumulated other comprehensive income (loss), net of taxes (Note 5)	1,792	(1,876)
Total shareholders' equity	82,909	74,721
	$ 720,353	$ 688,092

See accompanying notes to consolidated financial statements.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31, 2019, 2018 and 2017
(Dollars in thousands, except per share data)

	2019	2018	2017
Interest income:			
Interest and fees on loans and leases:			
Taxable	$ 16,834	$ 13,924	$ 13,947
Exempt from Federal income taxes	781	529	499
Interest on deposits in banks	201	33	13
Interest on Federal funds sold	5	348	-
Interest and dividends on investment securities:			
Taxable	7,589	6,901	5,300
Exempt from Federal income taxes	260	507	655
Total interest income	25,670	22,242	20,414
Interest expense:			
Interest on deposits (Note 9)	2,078	1,359	855
Interest on borrowings	383	237	206
Total interest expense	2,461	1,596	1,061
Net interest income	23,209	20,646	19,353
Provision for loan and lease losses (Note 7)	660	175	450
Net interest income after provision for loan and lease losses	22,549	20,471	18,903
Noninterest income:			
Service charges	558	476	465
Gain on sale of investment securities (Note 5)	115	31	161
Other income (Note 15)	1,015	1,006	970
Total noninterest income	1,688	1,513	1,596
Noninterest expense:			
Salaries and employee benefits (Notes 6 and 16)	11,316	10,203	8,920
Other real estate expense	134	20	44
Occupancy (Notes 8, 12 and 17)	1,023	1,050	1,053
Furniture and equipment (Notes 8 and 12)	542	553	586
Regulatory assessments	126	280	280
Other expense (Note 15)	3,705	3,404	3,166
Total noninterest expense	16,846	15,510	14,049
Income before provision for income taxes	7,391	6,474	6,450
Provision for income taxes (Note 11)	1,891	1,574	3,252
Net income	$ 5,500	$ 4,900	$ 3,198
Basic earnings per share (Note 13)	$ 0.94	$ 0.83	$ 0.50
Diluted earnings per share (Note 13)	$ 0.94	$ 0.83	$ 0.50

See accompanying notes to consolidated financial statements.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31, 2019, 2018 and 2017
(Dollars in thousands)

	2019	2018	2017
Net income	$ 5,500	$ 4,900	$ 3,198
Other comprehensive income (loss):			
Increase (decrease) in net unrealized gains on investment securities	5,322	(2,225)	(1,211)
Deferred tax (expense) benefit	(1,573)	691	491
Increase (decrease) in net unrealized gains on investment securities, net of tax	3,749	(1,534)	(720)
Reclassification adjustment for realized gains included in net income	(115)	(31)	(161)
Tax effect	34	10	64
Realized gains, net of tax	(81)	(21)	(97)
Total other comprehensive income (loss)	3,668	(1,555)	(817)
Comprehensive income	$ 9,168	$ 3,345	$ 2,381

See accompanying notes to consolidated financial statements.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Years Ended December 31, 2019, 2018 and 2017
(Dollars in thousands)

	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss) (Net of Taxes)	Total Share-holders' Equity
Balance, January 1, 2017	6,661,726	$ 42,484	$ 40,822	$ 544	$ 83,850
Net income	-	-	3,198	-	3,198
Other comprehensive loss, net of tax (Note 5)	-	-	-	(817)	(817)
Disproportionate tax effect resulting from H.R.1 Tax Act (Note 2)	-	-	48	(48)	-
Payment of cash dividend, $0.20 per share (Note 14)	-	-	(1,293)	-	(1,293)
Retirement of common stock (Note 13)	(574,748)	(8,641)	-	-	(8,641)
Net restricted stock award activity and related compensation expense (Note 13)	3,486	248	4	-	252
Stock options exercised (Note 13)	41,898	351	-	-	351
Stock option compensation expense (Note 13)	-	21	-	-	21
Balance, December 31, 2017	6,132,362	34,463	42,779	(321)	76,921
Net income	-	-	4,900	-	4,900
Other comprehensive loss, net of tax (Note 5)	-	-	-	(1,555)	(1,555)
Payment of cash dividend, $0.20 per share (Note 14)	-	-	(1,188)	-	(1,188)
Retirement of common stock (Note 13)	(306,618)	(4,773)	-	-	(4,773)
Net restricted stock award activity and related compensation expense (Note 13)	11,374	196	3	-	199
Stock options exercised (Note 13)	21,310	189	-	-	189
Stock option compensation expense (Note 13)	-	28	-	-	28
Balance, December 31, 2018	5,858,428	30,103	46,494	(1,876)	74,721
Net income	-	-	5,500	-	5,500
Other comprehensive income, net of tax (Note 5)	-	-	-	3,668	3,668
Payment of cash dividend, $0.24 per share (Note 14)	-	-	(1,413)	-	(1,413)
Net restricted stock award activity and related compensation expense (Note 13)	29,310	324	-	-	324
Stock options exercised (Note 13)	11,140	95	-	-	95
Stock option compensation expense (Note 13)	-	14	-	-	14
Balance, December 31, 2019	5,898,878	$ 30,536	$ 50,581	$ 1,792	$ 82,909

See accompanying notes to consolidated financial statements.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2019, 2018 and 2017
(Dollars in thousands)

	2019	2018	2017
Cash flows from operating activities:			
Net income	$ 5,500	$ 4,900	$ 3,198
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan and lease losses	660	175	450
Change in deferred loan and lease origination fees, costs and purchase premiums, net	(384)	(239)	(20)
Depreciation and amortization	226	265	333
Amortization of investment security premiums and discounts, net	1,455	2,404	3,246
Gain on sale of investment securities	(115)	(31)	(161)
Increase in cash surrender value of life insurance policies	(334)	(307)	(317)
Deferred income tax (benefit) expense	(752)	333	1,247
Stock-based compensation expense	338	227	273
Loss (gain) on sale or write-down of other real estate owned	111	4	(8)
Increase in accrued interest receivable and other assets	(523)	(125)	(537)
Increase (decrease) in accrued interest payable and other liabilities	1,688	76	(173)
Net cash provided by operating activities	7,870	7,682	7,531
Cash flows from investing activities:			
Proceeds from the sale of available-for-sale investment securities	63,325	27,003	31,289
Proceeds from called available-for-sale investment securities	-	2,139	145
Proceeds from matured available-for-sale investment securities	5,255	-	1,930
Purchases of available-for-sale investment securities	(75,732)	(110,615)	(89,273)
Proceeds from principal repayments for available-for-sale mortgage-backed securities	46,705	44,321	43,150
Proceeds from principal repayments for held-to-maturity mortgage-backed securities	44	86	105
Net (increase) decrease in loans and leases	(54,598)	(290)	14,944
Proceeds from sale of loans	-	1,349	-
Purchases of loans	(20,964)	(10,799)	-
Net proceeds from sale of other real estate owned	-	-	395
Purchases of equipment	(346)	(178)	(129)
Net increase in FHLB stock	(327)	-	(153)
Net cash (used in) provided by investing activities	(36,638)	(46,984)	2,403

(Continued)

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Continued)
For the Years Ended December 31, 2019, 2018 and 2017
(Dollars in thousands)

	2019	2018	2017
Cash flows from financing activities:			
Net increase in demand, interest-bearing and savings deposits	$ 28,431	$ 26,198	$ 14,552
Net (decrease) increase in time deposits	(14,268)	8,396	(3,278)
Cash paid to repurchase common stock	-	(4,773)	(8,641)
Proceeds from exercised options	95	189	351
Decrease in long-term borrowings	-	(1,500)	-
Increase in short-term borrowings	4,000	1,500	-
Cash dividends paid	(1,413)	(1,188)	(1,293)
Net cash provided by financing activities	16,845	28,822	1,691
(Decrease) increase in cash and cash equivalents	(11,923)	(10,480)	11,625
Cash and cash equivalents at beginning of year	29,733	40,213	28,588
Cash and cash equivalents at end of year	$ 17,810	$ 29,733	$ 40,213
Supplemental disclosure of cash flow information:			
Right of use asset and obligation recorded upon adoption of ASU 2016-02	$ 3,570	$ -	$ -
Addition to right of use asset and obligation recorded upon renewal of existing lease	$ 234	$ -	$ -
Cash paid during the year for:			
Interest expense	$ 2,519	$ 1,598	$ 1,058
Income taxes	$ 1,888	$ 1,095	$ 2,375
Non-cash activities:			
Real estate acquired through foreclosure, repossession or deed in lieu of foreclosure	$ 517	$ -	$ -

See accompanying notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. THE BUSINESS OF THE COMPANY

American River Bankshares (the "Company") was incorporated under the laws of the State of California in 1995 under the name of American River Holdings and changed its name in 2004 to American River Bankshares. As a bank holding company, the Company is authorized to engage in the activities permitted under the Bank Holding Company Act of 1956, as amended, and regulations thereunder. As a community oriented regional bank holding company, the principal communities served are located in Sacramento, Placer, Yolo, El Dorado, Amador, and Sonoma counties.

The Company owns 100% of the issued and outstanding common shares of its banking subsidiary, American River Bank ("ARB" or the "Bank"). ARB was incorporated in 1983. ARB accepts checking and savings deposits, offers money market deposit accounts and certificates of deposit, makes secured and unsecured commercial, secured real estate, and other installment and term loans and offers other customary banking services. ARB operates four full-service banking offices in Sacramento County, one full-service banking office in Placer County, two full-service banking offices in Sonoma County, and three full-service banking offices in Amador County. The Company also owns one inactive subsidiary, American River Financial.

ARB does not offer trust services or international banking services and does not plan to do so in the near future. The deposits of ARB are insured by the Federal Deposit Insurance Corporation (the "FDIC") up to applicable legal limits.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

The accounting and reporting policies of the Company and its subsidiaries conform to accounting principles generally accepted in the United States of America and prevailing practices within the financial services industry.

Reclassifications

Certain reclassifications have been made to prior years' balances to conform to classifications used in 2019. Reclassifications did not affect prior year net income or shareholders' equity.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany transactions and accounts among the Company and its subsidiaries have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Cash Equivalents

For the purpose of the statement of cash flows, cash and due from banks and Federal funds sold are considered to be cash equivalents. Generally, Federal funds are sold for one-day periods. Interest-bearing deposits in banks are also considered to be cash equivalents, mature within one year and are carried at cost.

Investment Securities

Investments are classified into the following categories:

- Available-for-sale securities, reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders' equity.

- Held-to-maturity securities, which management has the positive intent and ability to hold to maturity, reported at amortized cost.

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. There were no transfers during the years ended December 31, 2019 and 2018.

Gains or losses on the sale of investment securities are computed on the specific identification method. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums.

An investment security is impaired when its carrying value is greater than its fair value. Investment securities that are impaired are evaluated on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Company to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. For debt securities, once a decline in value is determined to be other than temporary and management does not intend to sell the security or it is more likely than not that management will not be required to sell the security before recovery, only the portion of the impairment loss representing credit exposure is recognized as a charge to earnings, with the balance recognized as a charge to other comprehensive income. If management intends to sell the security or it is more likely than not that management will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings. For any equity securities, the entire amount of the fair value adjustment is recognized through earnings.

Federal Home Loan Bank Stock

Investments in Federal Home Loan Bank of San Francisco (the "FHLB") stock are carried at cost and are redeemable at par with certain restrictions. Investments in FHLB stock are necessary to participate in FHLB programs.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans and Leases

Loans and leases that management has both the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal amounts outstanding, adjusted for unearned income, deferred loan origination fees and costs, purchase premiums and discounts, write-downs and the allowance for loan and lease losses. Loan and lease origination fees, net of certain deferred origination costs, and purchase premiums and discounts are recognized as an adjustment to the yield of the related loans and leases.

For all classes of loans and leases, the accrual of interest is discontinued when, in the opinion of management, there is an indication that the borrower may be unable to meet payment requirements within an acceptable time frame relative to the terms stated in the loan agreement. Upon such discontinuance, all unpaid accrued interest is reversed against current income unless the loan or lease is well secured and in the process of collection. Interest received on nonaccrual loans and leases is either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, loans and leases are restored to accrual status when the obligation is brought current and has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

Direct financing leases are carried net of unearned income. Income from leases is recognized by a method that approximates a level yield on the outstanding net investment in the lease.

Loan Sales and Servicing

Included in the loan and lease portfolio are Small Business Administration ("SBA") loans and Farm Service Agency guaranteed loans that may be sold in the secondary market. At the time the loan is sold, the related right to service the loan is either retained, with the Company earning future servicing income, or released in exchange for a one-time servicing-released premium. Loans subsequently transferred to the loan portfolio are transferred at the lower of cost or fair value at the date of transfer. Any difference between the carrying amount of the loan and its outstanding principal balance is recognized as an adjustment to yield by the interest method. There were no loans held for sale at December 31, 2019 and 2018.

SBA and Farm Service Agency loans with unpaid balances of $78,000 and $109,000 were being serviced for others as of December 31, 2019 and 2018, respectively. The Company also serviced loans that are participated with other financial institutions totaling $4,042,000 and $7,815,000 as of December 31, 2019 and 2018, respectively.

Servicing rights acquired through 1) a purchase or 2) the origination of loans which are sold or securitized with servicing rights retained are recognized as separate assets or liabilities. Servicing assets or liabilities are initially recorded at fair value and are subsequently amortized in proportion to and over the period of the related net servicing income or expense. Servicing assets are periodically evaluated for impairment. Servicing assets were not considered material for disclosure purposes at December 31, 2019 and 2018.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses is an estimate of probable credit losses inherent in the Company's credit portfolio that have been incurred as of the balance-sheet date. The allowance is established through a provision for loan and lease losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is typically recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired credits and general reserves for inherent probable losses related to credits that are not impaired.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan and Lease Losses (Continued)

For all classes of the portfolio, a loan or lease is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. Factors considered by management in determining impairment include payment status, and the probability of collecting scheduled principle and interest payments when due. Impaired loans are individually evaluated to determine the extent of impairment, if any, except for smaller-balance loans that are collectively evaluated for credit risk. When a loan or lease is impaired, the Company measures impairment based on the present value of expected future cash flows discounted at the credit's original interest rate, the credit's observable market price, or the fair value of the collateral if the credit is collateral dependent. A loan or lease is collateral dependent if the repayment of the credit is expected to be provided solely by the sale or operation of the underlying collateral.

For all portfolio segments, a restructuring of a debt constitutes a troubled debt restructuring ("TDR") if the Company grants a concession to the borrower for economic or legal reasons related to the borrower's financial difficulties that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans or leases that are reported as TDRs are considered impaired and measured for impairment as described above.

For all portfolio segments, the determination of the general reserve for loans and leases that are not impaired is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment, internal asset classifications, and qualitative factors to include economic trends in the Company's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the credit portfolio, and probable losses inherent in the portfolio taken as a whole.

The Company determines a separate allowance for each portfolio segment. These portfolio segments include commercial, real estate construction (including land and development loans), residential real estate, multi-family real estate, commercial real estate, leases, agriculture, and consumer loans. The allowance for loan and lease losses attributable to each portfolio segment, which includes both impaired credits and credits that are not impaired, is combined to determine the Company's overall allowance, which is included as a component of loans and leases on the consolidated balance sheet and available for all loss exposures.

The Company assigns a risk rating to all loans and periodically performs detailed reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Company and the Company's regulators. During the internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual credit. The risk ratings can be grouped into six major categories, defined as follows:

Pass – A pass loan is a strong credit with no existing or known potential weaknesses deserving of management's close attention.

Watch – A watch credit is a loan or lease that otherwise meets the definition of a standard or minimum acceptable quality loan, but which requires more than normal attention due to any of the following items: deterioration of borrower financial condition less severe than those warranting more adverse grading, deterioration of repayment ability and/or collateral value, increased leverage, adverse effects from a downturn in the economy, local market or industry, adverse changes in local or regional employer, management changes (including illness, disability, and death), and adverse legal action. Payments are current per the terms of the agreement. If conditions persist or worsen, a more severe risk grade may be warranted.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan and Lease Losses (Continued)

Special Mention – A special mention credit is a loan or lease that has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the credit or in the Company's position at some future date. Special Mention credits are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

Substandard – A substandard credit is a loan or lease that is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Credits classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well defined weaknesses include inadequate cash flow or collateral support, a project's lack of marketability, failure to complete construction on time or a project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful – Credits classified as doubtful are loans or leases that have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

Loss – Credits classified as loss are loans or leases considered uncollectible and charged off immediately.

The general reserve component of the allowance for loan and lease losses also consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) inherent credit risk, (2) historical losses and (3) other qualitative factors. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below.

Real Estate- Commercial – Commercial real estate mortgage loans generally possess a higher inherent risk of loss than other real estate portfolio segments, except land and construction loans. Adverse economic developments or an overbuilt market impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flow to service debt obligations.

Real Estate- Construction – These loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within specified cost and time lines. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

Real Estate- Multi-family – Multi-family loans are non-construction term mortgages for the acquisition, refinance, or improvement of residential rental properties with generally more than 4 dwelling units. Underwriting is generally based on borrower creditworthiness, sufficiency of net operating income to service the bank loan payment, and a prudent loan-to-value ratio, among other factors.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan and Lease Losses (Continued)

Real Estate- Residential – Residential loans are generally loans to purchase or refinance 1-4 unit single-family residences, either owner-occupied or investor-owned. Some residential loans are short term to match their intended source of repayment through sale or refinance. The remainder are fixed or floating-rate term first mortgages with an original maturity between 2 and 10 years, generally with payments based on a 25-30 year amortization.

Commercial – Commercial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

Lease Financing Receivable – Leases originated by the bank are non-consumer finance leases (as contrasted with operating leases) for the acquisition of titled and non-titled business equipment. Leases are generally amortized over a period from 36 to 84 months, depending on the useful life of the equipment acquired. Residual (balloon) payments at lease end range from 0-20% of original cost, and are a non-optional obligation of the lessee. Lessees are contractually responsible for all costs, expenses, taxes, and liability associated with the leased equipment.

Agricultural – Loans secured by crop production and livestock are especially vulnerable to two risk factors that are largely outside the control of the Company and borrowers: commodity prices and weather conditions.

Consumer – The consumer loan portfolio is comprised of a large number of small loans scheduled to be amortized over a specific period. Most installment loans are made directly for consumer purchases, but business loans granted for the purchase of heavy equipment or industrial vehicles may also be included. Also included in the consumer loan portfolio are home equity lines of credit and loans purchased from a specialty lender that originates classic and collector auto loans. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Although management believes the allowance to be adequate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Company's primary regulators, the FDIC and the California Department of Business Oversight, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations.

Allowance for Credit Losses on Off-Balance-Sheet Credit Exposures

The Company also maintains a separate allowance for off-balance-sheet commitments. Management estimates probable incurred losses using historical data and utilization assumptions. The allowance for off-balance-sheet commitments is included in accrued interest payable and other liabilities on the consolidated balance sheet.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Other Real Estate Owned (OREO)

Other real estate owned includes real estate acquired in full or partial settlement of loan obligations. When property is acquired, any excess of the recorded investment in the loan balance and accrued interest income over the estimated fair market value of the property less estimated selling costs is charged against the allowance for loan and lease losses. Any excess of the fair value over the loan balance less estimated selling costs is recorded as noninterest income-other income. A valuation allowance for losses on other real estate may be maintained to provide for temporary declines in value. The valuation allowance is established through a provision for losses on other real estate which is included in other expenses. Subsequent gains or losses on sales or write-downs resulting from permanent impairments are recorded in other income or expense as incurred.

Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation. Land is not depreciated. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful life of the building and improvements is forty years. The useful lives of furniture, fixtures and equipment are estimated to be three to ten years. Leasehold improvements are amortized over the life of the asset or the term of the related lease, whichever is shorter. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. Impairment of long-lived assets is evaluated by management based upon an event or changes in circumstances surrounding the underlying assets which indicate long-lived assets may be impaired.

Goodwill and Intangible Assets

Business combinations involving the Company's acquisition of equity interests or net assets of another enterprise or the assumption of net liabilities in an acquisition of branches constituting a business may give rise to goodwill. Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed. The value of goodwill is ultimately derived from the Company's ability to generate net earnings after the acquisition and is not deductible for tax purposes. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed for impairment at least annually. Impairment exists when a reporting unit’s carrying value of goodwill exceeds its fair value. At December 31, 2019, the Company had one reporting unit and that reporting unit had positive equity and the Company elected to perform a qualitative assessment to determine if it was more likely than not that the fair value of the reporting unit exceeded its carrying value, including goodwill. The qualitative assessment indicated that it was more likely than not that the fair value of the reporting unit exceeded its carrying value, resulting in no impairment.

Bank-Owned Life Insurance

The Company has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

The Company files its income taxes on a consolidated basis with its subsidiaries. The allocation of income tax expense represents each entity's proportionate share of the consolidated provision for income taxes.

The Company accounts for income taxes using the balance sheet method, under which deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amounts of assets and liabilities and their tax bases. The deferred provision for income taxes is the result of the net change in the deferred tax asset and deferred tax liability balances during the year. This amount combined with the current taxes payable or refundable, results in the income tax expense for the current year. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. On December 22, 2017, President Trump signed into law "H.R.1" commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). During 2017, the Company recorded an income tax expense adjustment of $1,220,000 related to the Tax Act. The adjustment relates to revaluing the Company’s net deferred tax assets using the new lower corporate federal income tax rate of 21% which became effective January 1, 2018, a reduction from the Company’s 2017 rate of 34%.

The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax assets will not be realized. "More likely than not" is defined as greater than a 50% likelihood. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Based upon the Company's analysis of available evidence, the Company determined that it is "more likely than not" that all of the deferred income tax assets as of December 31, 2019 and 2018 will be fully realized and therefore no valuation allowance was recorded.

The Company uses a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the consolidated statement of income.

Comprehensive Income

Comprehensive income is reported in addition to net income for all periods presented. Comprehensive income consists of net income and other comprehensive income (loss). Unrealized gains and losses on the Company's available-for-sale investment securities are included in other comprehensive income (loss), adjusted for realized gains or losses included in net income, net of tax. Total comprehensive income and the components of accumulated other comprehensive income (loss) are presented in the consolidated statements of comprehensive income.

Earnings Per Share

Basic earnings per share ("EPS"), which excludes dilution, is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options or restricted stock, result in the issuance of common stock that share in the earnings of the Company. The treasury stock method has been applied to determine the dilutive effect of stock options and restricted stock in computing diluted EPS. Earnings and dividends per share are restated for all stock splits and stock dividends through the date of issuance of the consolidated financial statements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

There were no stock splits or stock dividends in 2019, 2018 or 2017.

Stock-Based Compensation

At December 31, 2019, the Company had one stock-based compensation plan, which is described more fully in Note 13. Compensation expense recorded in 2019, 2018, and 2017 totaled $338,000, $227,000 and $273,000, respectively. Compensation expense is recognized over the vesting period on a straight line accounting basis.

The fair value of each option award is estimated on the date of grant using a Black-Scholes-Merton based option valuation model that uses the assumptions noted in the table in Footnote 13. Because Black-Scholes-Merton based option valuation models incorporate ranges of assumptions for inputs, those ranges are disclosed. Expected volatilities are based on historical volatility of the Company's stock and other factors. The Company uses historical data to estimate the dividend yield, option life and forfeiture rate within the valuation model. The expected option life represents the period of time that options granted are expected to be outstanding. The risk-free rate for the period representing the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

Operating Segments

While the Company's management monitors the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Operating segments are aggregated into one as operating results for all segments are similar. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable operating segment.

Recently Issued Financial Accounting Pronouncements

In June 2016, the Financial Accounting Standards Board (the "FASB") issued ASU No. 2016-13, "*Measurement of Credit Losses on Financial Instruments.*" This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. In issuing the standard, the FASB is responding to criticism that today's guidance delays recognition of credit losses. The standard will replace today's "incurred loss" approach with an "expected loss" model. The new model, referred to as the current expected credit loss ("CECL") model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for-sale ("AFS") debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. As a result, entities will recognize changes to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. The ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU No. 2016-13 was initially scheduled to become effective for the Company for interim and annual reporting periods beginning after December 15, 2019, however, on November 15, 2019 the FASB issued ASU 2019-10 delaying the effective date for smaller reporting companies, such as the Company, to interim and annual reporting periods beginning after December 15, 2022; early adoption is still permitted for interim and annual reporting periods beginning after December 15, 2018. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). While the Company is currently evaluating the

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

provisions of ASU No. 2016-13 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements, including if it will early adopt the standard, it has taken steps to prepare for the implementation when it becomes effective, such as forming an internal task force, gathering pertinent data, consulting with outside professionals, evaluating its current IT systems, and purchasing a software solution. The Company has imported current and historical data into the new software and is currently validating the data and intends to begin processing information, on a test basis, with the new CECL specific software during 2020 and 2021 and to disclose any material potential impact of this modeling once it becomes available.

3. FAIR VALUE MEASUREMENTS

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2019 and December 31, 2018. They indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. In 2018, the Company adopted the provisions of Accounting Standard Update 2016-01 "*Recognition and Measurement of Financial Assets and Financial Liabilities*" ("ASU 2016-01"). ASU 2016-01 requires the Company to use the exit price notion when measuring the fair value of financial instruments. The Company used the exit price notion for valuing financial instruments in 2018 and 2019. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

Estimated fair values are disclosed for financial instruments for which it is practicable to estimate fair value. These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. These 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 the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

The carrying amounts and estimated fair values of the Company's financial instruments are as follows (dollars in thousands):

3. FAIR VALUE MEASUREMENTS (Continued)

December 31, 2019	Carrying Amount	Fair Value Measurements Using: Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$ 15,258	$ 15,258	$ -	$ -	$ 15,258
Interest-bearing deposits in banks	2,552	-	2,552	-	2,552
Available-for-sale securities	261,965	-	261,965	-	261,965
Held-to-maturity securities	248	-	266	-	266
FHLB stock	4,259	N/A	N/A	N/A	N/A
Loans and leases, net	393,802	-	-	396,089	396,089
Accrued interest receivable	1,929	-	780	1,149	1,929
Financial liabilities:					
Deposits:					
Noninterest-bearing	$ 227,055	$ 227,055	$ -	$ -	$ 227,055
Savings	75,820	75,820	-	-	75,820
Money market	158,319	158,319	-	-	158,319
NOW accounts	69,834	69,834	-	-	69,834
Time Deposits	73,809	-	73,924	-	73,924
Short-term borrowings	9,000	9,000	-	-	9,000
Long-term borrowings	10,500	-	10,717	-	10,717
Accrued interest payable	120	-	120	-	120

December 31, 2018	Carrying Amount	Fair Value Measurements Using: Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$ 20,987	$ 20,987	$ -	$ -	$ 20,987
Federal funds sold	7,000	7,000	-	-	7,000
Interest-bearing deposits in banks	1,746	-	1,746	-	1,746
Available-for-sale securities	294,933	4,976	289,957	-	294,933
Held-to-maturity securities	292	-	306	-	306
FHLB stock	3,932	N/A	N/A	N/A	N/A
Loans and leases, net	318,516	-	-	315,235	315,235
Accrued interest receivable	1,959	-	1,044	915	1,959
Financial liabilities:					
Deposits:					
Noninterest-bearing	$ 214,745	$ 214,745	$ -	$ -	$ 214,745
Savings	72,522	72,522	-	-	72,522
Money market	145,831	145,831	-	-	145,831
NOW accounts	69,489	69,489	-	-	69,489
Time Deposits	88,087	-	88,078	-	88,078
Short-term borrowings	5,000	5,000	-	-	5,000
Long-term borrowings	10,500	-	10,733	-	10,733
Accrued interest payable	63	-	63	-	63

Because no established market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature 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.

3. FAIR VALUE MEASUREMENTS (Continued)

Assets and liabilities measured at fair value on a recurring and non-recurring basis are presented in the following table:

(Dollars in thousands)

December 31, 2019	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses)
Assets and liabilities measured on a recurring basis:					
Available-for-sale securities:					
U.S. Government Agencies and Sponsored Agencies	$ 241,887	$ -	$ 241,887	$ -	$ -
Corporate Debt Securities	6,631	-	6,631	-	-
Obligations of states and political subdivisions	13,447	-	13,477	-	-
Total recurring	$ 261,965	$ -	$ 261,965	$ -	$ -

December 31, 2019	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses)
Assets and liabilities measured on a nonrecurring basis:					
Other Assets:					
Repossessed asset	$ 517	$ -	$ -	$ 517	$ -
Other real estate owned:					
Land	846	-	-	846	(111)
Total nonrecurring	$ 1,363	$ -	$ -	$ 1,363	$ (111)

3. FAIR VALUE MEASUREMENTS (Continued)

(Dollars in thousands)

December 31, 2018	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses)
Assets and liabilities measured on a recurring basis:					
Available-for-sale securities:					
U.S. Government Agencies and Sponsored Agencies	$ 269,049	$ -	$ 269,049	$ -	$ -
Corporate Debt Securities	6,508	-	6,508	-	-
Obligations of states and political subdivisions	14,400	-	14,400	-	-
U.S. Treasury bonds	4,976	4,976	-	-	-
Total recurring	$ 294,933	$ 4,976	$ 289,957	$ -	$ -

December 31, 2018	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses)
Assets and liabilities measured on a nonrecurring basis:					
Impaired loans:					
Real estate:					
Commercial	$ 5,274	$ -	$ -	$ 5,274	$ -
Other real estate owned:					
Land	957	-	-	957	(4)
Total nonrecurring	$ 6,231	$ -	$ -	$ 6,231	$ (4)

U.S. Government Agencies and Sponsored Agencies consist predominately of residential mortgage-backed securities. There were no transfers between Levels 1 and 2 during the years ended December 31, 2019 or December 31, 2018.

The following methods were used to estimate the fair value of each class of financial instrument above:

Available-for-sale securities – Fair values for investment securities are based on quoted market prices, if available, and are considered Level 1, or evaluated using pricing models that vary by asset class and incorporate available trade, bid and other market information and are considered Level 2. Pricing applications apply available information, as applicable, through processes such as benchmark curves, benchmarking to like securities, sector groupings and matrix pricing.

Impaired loans – The fair value of collateral dependent impaired loans adjusted for specific allocations of the allowance for loan losses is generally based on recent real estate appraisals and/or evaluations. These appraisals and/or evaluations may utilize a single valuation approach or a combination of approaches including comparable sales, cost and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income and other available data. Such adjustments are usually significant and typically result in a Level 3 classification

3. FAIR VALUE MEASUREMENTS (Continued)

of the inputs for determining fair value. The valuation technique used for all Level 3 nonrecurring impaired loans is the sales comparison approach less a reserve for past dues taxes and selling costs ranging from 8% to 10%.

Other assets and real estate owned – Other assets can contain non-real estate property obtained by repossession of collateral in the case of a loan default and are measured at fair value, less costs to sell. Certain commercial and residential real estate properties classified as OREO are measured at fair value, less costs to sell. Fair values are based on recent appraisals and/or evaluations. These appraisals and/or evaluations may use a single valuation approach or a combination of approaches including comparable sales, cost and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income and other available data. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. The valuation technique used for all Level 3 nonrecurring other assets and OREO is the sales comparison approach less selling costs ranging from 8% to 10%.

4. GOODWILL AND OTHER INTANGIBLE ASSETS

At December 31, 2019 and 2018, goodwill totaled $16,321,000. Goodwill is evaluated annually for impairment under the provisions of the codification Topic 350, *Goodwill and Other Intangibles.* The most recent annual assessment was performed as of December 31, 2019, and at that time, the Company's reporting unit had positive equity and the Company elected to perform a qualitative assessment to determine if it was more likely than not that the fair value of the reporting unit exceeded its carrying value, including goodwill. The qualitative assessment indicated that it was more likely than not that the fair value of the reporting unit exceeded its carrying value, resulting in no impairment. Management determined that no impairment recognition was required for the years ended December 31, 2019, 2018 and 2017.

At December 31, 2019 and 2018, the Company did not have other intangible assets.

5. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities at December 31, 2019 and 2018 consisted of the following (dollars in thousands):

Available-for-Sale

	2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government Agencies and Sponsored Agencies	$ 239,617	$ 3,371	$ (1,101)	$ 241,887
Obligations of states and political subdivisions	13,308	212	(73)	13,447
Corporate Debt Securities	6,496	135	-	6,631
	$ 259,421	$ 3,718	$ (1,174)	$ 261,965

	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government Agencies and Sponsored Agencies	$ 271,685	$ 984	$ (3,620)	$ 269,049
Obligations of states and political subdivisions	14,440	165	(205)	14,400
Corporate Debt Securities	6,493	74	(59)	6,508
U.S. Treasury securities	4,979	-	(3)	4,976
	$ 297,597	$ 1,223	$ (3,887)	$ 294,933

U.S. Government Agencies and U.S. Government-sponsored Agencies consist predominately of residential mortgage-backed securities. Net unrealized gains on available-for-sale investment securities totaling $2,544,000 were recorded, net of $752,000 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2019. Proceeds and gross realized gains from the sale and call of available-for-sale investment securities for the year ended December 31, 2019 totaled $63,325,000 and $115,000, respectively. There were no transfers of available-for-sale investment securities during the year ended December 31, 2019.

Net unrealized losses on available-for-sale investment securities totaling $2,664,000 were recorded, net of $788,000 in tax assets, as accumulated other comprehensive income within shareholders' equity at December 31, 2018. Proceeds and gross realized gains from the sale and call of available-for-sale investment securities for the year ended December 31, 2018 totaled $29,142,000 and $31,000, respectively. There were no transfers of available-for-sale investment securities during the year ended December 31, 2018.

Proceeds and gross realized gains from the sale, impairment and call of available-for-sale investment securities for the year ended December 31, 2017 totaled $31,434,000 and $161,000, respectively.

5. INVESTMENT SECURITIES (Continued)

Held-to-Maturity

	2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government Agencies and Sponsored Agencies	$ 248	$ 18	$ -	$ 266

	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government Agencies and Sponsored Agencies	$ 292	$ 14	$ -	$ 306

There were no sales or transfers of held-to-maturity investment securities for the years ended December 31, 2019, 2018 and 2017.

The amortized cost and estimated fair value of investment securities at December 31, 2019 by contractual maturity are shown below (dollars in thousands).

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Within one year	$ 500	$ 501		
After one year through five years	2,937	2,955		
After five years through ten years	9,196	9,351		
After ten years	7,171	7,271		
	19,804	20,078		
Investment securities not due at a single maturity date:				
U.S. Government Agencies and Sponsored Agencies	239,617	241,887	$ 248	$ 266
	$ 259,421	$ 261,965	$ 248	$ 266

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.

5. INVESTMENT SECURITIES (Continued)

Investment securities with amortized costs totaling $127,307,000 and $88,460,000 and estimated fair values totaling $129,643,000 and $87,351,000 were pledged to secure State Treasury funds on deposit, public agency and bankruptcy trustee deposits and borrowing arrangements (see Note 10) at December 31, 2019 and 2018, respectively.

Investment securities with unrealized losses at December 31, 2019 and 2018 are summarized and classified according to the duration of the loss period as follows (dollars in thousands):

	2019					
	Less than 12 Months		12 Months or More		Total	
Available-for-Sale	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Government Agencies and Sponsored Agencies	$ 65,082	$ (438)	$ 38,380	$ (663)	$ 103,462	$ (1,101)
Obligations of states and political subdivisions	8,060	(73)	-	-	8,060	(73)
	$ 73,142	$ (511)	$ 38,380	$ (663)	$ 111,522	$ (1,174)

	2018					
	Less than 12 Months		12 Months or More		Total	
Available-for-Sale	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Government Agencies and Sponsored Agencies	$ 39,267	$ (310)	$ 138,894	$ (3,310)	$ 178,161	$ (3,620)
Obligations of states and political subdivisions	2,168	(28)	5,583	(177)	7,751	(205)
U.S. Treasury securities	4,976	(3)	-	-	4,976	(3)
Corporate bonds	497	(4)	1,938	(55)	2,435	(59)
	$ 46,908	$ (345)	$ 146,415	$ (3,542)	$ 193,323	$ (3,887)

At December 31, 2019, the Company held 205 securities of which 41 were in a loss position for less than twelve months and 29 were in a loss position for twelve months or more. These 29 securities consisted of mortgage-backed, corporate and municipal securities.

The unrealized loss on the Company's investments in securities is primarily driven by interest rates. Because the decline in market value is attributable to a change in interest rates and not credit quality, and because the Company has the ability and intent to hold these investments until recovery of fair value, which may be maturity, management does not consider these investments to be other-than-temporarily impaired.

6. LOANS AND LEASES

Outstanding loans and leases are summarized as follows (dollars in thousands):

	December 31, 2019	December 31, 2018
Real estate – commercial	$ 214,604	$ 199,894
Real estate – construction	23,169	5,685
Real estate – multi-family	56,818	56,139
Real estate – residential	29,180	16,338
Commercial	43,019	29,650
Lease financing receivable	-	32
Agriculture	6,479	4,419
Consumer	25,671	10,714
	398,940	322,871
Deferred loan and lease origination fees and costs, net	-	37
Allowance for loan and lease losses	(5,138)	(4,392)
	$ 393,802	$ 318,516

Certain loans are pledged as collateral for available borrowings with the FHLB and the Federal Reserve Bank of San Francisco (the "FRB"). Pledged loans totaled $220,918,000 and $194,431,000 at December 31, 2019 and 2018, respectively (see Note 10).

Salaries and employee benefits totaling $438,000, $357,000 and $177,000 have been deferred as loan and lease origination costs for the years ended December 31, 2019, 2018 and 2017, respectively.

7. ALLOWANCE FOR LOAN AND LEASE LOSSES

The following tables show the activity in the allowance for loan and lease losses for the years ended December 31, 2019, 2018 and 2017 and the allocation of the allowance for loan and lease losses as of December 31, 2019, 2018 and 2017 by portfolio segment and by impairment methodology (dollars in thousands):

	December 31, 2019								
		Real Estate				Other			
	Commercial	Commercial	Multi-Family	Construction	Residential	Agriculture	Consumer	Unallocated	Total
Allowance for Loan and Lease Losses									
Beginning balance	$ 668	$ 2,114	$ 564	$ 267	$ 220	$ 88	$ 192	$ 279	$ 4,392
Provision for loan losses	275	(219)	(235)	719	61	19	74	(34)	660
Loans charged-off	—	—	—	—	—	—	—	—	—
Recoveries	7	11	—	—	—	—	68	—	86
Ending balance allocated to portfolio segments	$ 950	$ 1,906	$ 329	$ 986	$ 281	$ 107	$ 334	$ 245	$ 5,138
Ending balance: Individually evaluated for impairment	$ —	$ 133	$ —	$ —	$ 9	$ —	$ —	$ —	$ 142
Ending balance: Collectively evaluated for impairment	$ 950	$ 1,773	$ 329	$ 986	$ 272	$ 107	$ 334	$ 245	$ 4,996
Loans									
Ending balance	$ 43,019	$ 214,604	$ 56,818	$ 23,169	$ 29,180	$ 6,479	$ 25,671	$ —	$ 398,940
Ending balance: Individually evaluated for impairment	$ —	$ 7,152	$ —	$ —	$ 452	$ —	$ —	$ —	$ 7,604
Ending balance: Collectively evaluated for impairment	$ 43,019	$ 207,452	$ 56,818	$ 23,169	$ 28,728	$ 6,479	$ 25,671	$ —	$ 391,336

7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

	December 31, 2018									
		Real Estate				Other				
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	Unallocated	Total
Allowance for Loan and Lease Losses										
Beginning balance	$ 447	$ 2,174	$ 1,047	$ 269	$ 205	$ —	$ 31	$ 14	$ 291	$ 4,478
Provision for loan losses	422	(68)	(483)	(2)	15	(1)	57	247	(12)	175
Loans charged-off	(213)	—	—	—	—	—	—	(69)	—	(282)
Recoveries	12	8	—	—	—	1	—	—	—	21
Ending balance allocated to portfolio segments	$ 668	$ 2,114	$ 564	$ 267	$ 220	$ —	$ 88	$ 192	$ 279	$ 4,392
Ending balance: Individually evaluated for impairment	$ —	$ 132	$ —	$ —	$ 53	$ —	$ —	$ —	$ —	$ 185
Ending balance: Collectively evaluated for impairment	$ 668	$ 1,982	$ 564	$ 267	$ 167	$ —	$ 88	$ 192	$ 279	$ 4,207
Loans										
Ending balance	$ 29,650	$ 199,894	$ 56,139	$ 5,685	$ 16,338	$ 32	$ 4,419	$ 10,714	$ —	$ 322,871
Ending balance: Individually evaluated for impairment	$ —	$ 7,783	$ —	$ —	$ 919	$ —	$ —	$ —	$ —	$ 8,702
Ending balance: Collectively evaluated for impairment	$ 29,650	$ 192,111	$ 56,139	$ 5,685	$ 15,419	$ 32	$ 4,419	$ 10,714	$ —	$ 314,169

7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

	December 31, 2017									
		Real Estate				Other				
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	Unallocated	Total
Allowance for Loan and Lease Losses										
Beginning balance	$ 855	$ 2,050	$ 851	$ 446	$ 253	$ 1	$ 64	$ 24	$ 278	$ 4,822
Provision for loan losses	659	(104)	196	(177)	(48)	(42)	(33)	(14)	13	450
Loans charged-off	(1,073)	—	—	—	—	—	—	—	—	(1,073)
Recoveries	6	228	—	—	—	41	—	4	—	279
Ending balance allocated to portfolio segments	$ 447	$ 2,174	$ 1,047	$ 269	$ 205	$ —	$ 31	$ 14	$ 291	$ 4,478
Ending balance: Individually evaluated for impairment	$ —	$ 261	$ 21	$ —	$ 73	$ —	$ —	$ —	$ —	$ 355
Ending balance: Collectively evaluated for impairment	$ 447	$ 1,913	$ 1,026	$ 269	$ 132	$ —	$ 31	$ 14	$ 291	$ 4,123
Loans										
Ending balance	$ 25,377	$ 185,452	$ 78,025	$ 5,863	$ 15,813	$ 205	$ 1,713	$ 945	$ —	$ 313,393
Ending balance: Individually evaluated for impairment	$ 1,598	$ 10,070	$ 474	$ —	$ 1,615	$ —	$ —	$ —	$ —	$ 13,757
Ending balance: Collectively evaluated for impairment	$ 23,779	$ 175,382	$ 77,551	$ 5,863	$ 14,198	$ 205	$ 1,713	$ 945	$ —	$ 299,636

7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

The following tables show the loan portfolio allocated by management's internal risk ratings as of December 31, 2019 and 2018 (dollars in thousands):

	December 31, 2019							
	Credit Risk Profile by Internally Assigned Grade							
		Real Estate				Other Credit Exposure		
	Commercial	Commercial	Multi-Family	Construction	Residential	Agriculture	Consumer	Total
Grade:								
Pass	$ 38,085	$ 208,140	$ 56,818	$ 23,169	$ 28,570	$ 6,479	$ 25,596	$ 386,857
Watch	4,915	6,329	—	—	610	—	75	11,929
Special mention	19	—	—	—	—	—	—	19
Substandard	—	135	—	—	—	—	—	135
Doubtful	—	—	—	—	—	—	—	—
Total	$ 43,019	$ 214,604	$ 56,818	$ 23,169	$ 29,180	$ 6,479	$ 25,671	$ 398,940

	December 31, 2018								
	Credit Risk Profile by Internally Assigned Grade								
		Real Estate				Other Credit Exposure			
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	Total
Grade:									
Pass	$ 29,570	$ 185,548	$ 52,301	$ 5,685	$ 15,373	$ 32	$ 4,419	$ 10,691	$ 303,619
Watch	53	13,118	3,838	—	965	—	—	22	17,996
Special mention	—	1,087	—	—	—	—	—	1	1,088
Substandard	27	141	—	—	—	—	—	—	168
Doubtful	—	—	—	—	—	—	—	—	—
Total	$ 29,650	$ 199,894	$ 56,139	$ 5,685	$ 16,338	$ 32	$ 4,419	$ 10,714	$ 322,871

7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

The following tables show an aging analysis of the loan portfolio at December 31, 2019 and 2018 (dollars in thousands):

	December 31, 2019							
	30-59 Days Past Due	60-89 Days Past Due	Past Due Greater Than 90 Days	Total Past Due	Current	Total Loans	Past Due Greater Than 90 Days and Accruing	Nonaccrual
Commercial:								
Commercial	$ —	$ —	$ —	$ —	$ 43,019	$ 43,019	$ —	$ —
Real estate:								
Commercial	—	—	—	—	214,604	214,604	—	—
Multi-family	—	—	—	—	56,818	56,818	—	—
Construction	—	—	—	—	23,169	23,169	—	—
Residential	—	—	—	—	29,180	29,180	—	—
Other:								
Agriculture	—	—	—	—	6,479	6,479	—	—
Consumer	75	—	—	75	25,596	25,671	—	—
Total	$ 75	$ —	$ —	$ 75	$ 398,865	$ 398,940	$ —	$ —

7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

	December 31, 2018							
	30-59 Days Past Due	60-89 Days Past Due	Past Due Greater Than 90 Days	Total Past Due	Current	Total Loans	Past Due Greater Than 90 Days and Accruing	Nonaccrual
Commercial:								
Commercial	$ —	$ —	$ —	$ —	$ 29,650	$ 29,650	$ —	$ 27
Real estate:								
Commercial	—	—	—	—	199,894	199,894	—	—
Multi-family	—	—	—	—	56,139	56,139	—	—
Construction	—	—	—	—	5,685	5,685	—	—
Residential	—	—	—	—	16,338	16,338	—	—
Other:								
Leases	—	—	—	—	32	32	—	—
Agriculture	—	—	—	—	4,419	4,419	—	—
Consumer	—	—	—	—	10,714	10,714	—	—
Total	$ —	$ —	$ —	$ —	$ 322,871	$ 322,871	$ —	$ 27

7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

The following tables show information related to impaired loans as of and for the years ended December 31, 2019, 2018 and 2017 (dollars in thousands):

	December 31, 2019				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Real estate:					
Commercial	$ 5,530	$ 5,664	$ -	$ 5,654	$ 333
Residential	318	405	-	323	20
	$ 5,848	$ 6,069	$ -	$ 5,977	$ 353
With an allowance recorded:					
Real estate:					
Commercial	$ 1,622	$ 1,693	$ 133	$ 1,719	$ 101
Residential	134	134	9	149	7
	$ 1,756	$ 1,827	$ 142	$ 1,868	$ 108
Total:					
Real estate:					
Commercial	$ 7,152	$ 7,357	$ 133	$ 7,373	$ 434
Residential	452	539	9	472	27
	$ 7,604	$ 7,896	$ 142	$ 7,845	$ 461

7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

	December 31, 2018				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$ -	$ -	$ -	$ -	$ 4
Real estate:					
Commercial	5,645	5,879	-	5,711	283
Residential	323	410	-	326	18
	$ 5,968	$ 6,289	$ -	$ 6,037	$ 305
With an allowance recorded:					
Real estate:					
Commercial	$ 2,138	$ 2,217	$ 132	$ 2,199	$ 133
Residential	596	596	53	611	29
	$ 2,734	$ 2,813	$ 185	$ 2,810	$ 162
Total:					
Commercial	$ -	$ -	$ -	$ -	$ 4
Real estate:					
Commercial	7,783	8,096	132	7,910	416
Residential	919	1,006	53	937	47
	$ 8,702	$ 9,102	$ 185	$ 8,847	$ 467

7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

	December 31, 2017				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$ 1,598	$ 2,671	$ -	$ 1,808	$ 108
Real estate:					
Commercial	5,674	5,907	-	5,701	281
Residential	329	416	-	331	19
Other:					
Consumer	-	-	-	-	2
	$ 7,601	$ 8,994	$ -	$ 7,840	$ 410
With an allowance recorded:					
Real estate:					
Commercial	$ 4,396	$ 4,483	$ 261	$ 4,435	$ 249
Multi-family	474	474	21	476	33
Residential	1,286	1,286	73	1,295	62
	$ 6,156	$ 6,243	$ 355	$ 6,206	$ 344
Total:					
Commercial	$ 1,598	$ 2,671	$ -	$ 1,808	$ 108
Real estate:					
Commercial	10,070	10,390	261	10,136	530
Multi-family	474	474	21	476	33
Residential	1,615	1,702	73	1,626	81
Other:					
Consumer	-	-	-	-	2
	$ 13,757	$ 15,237	$ 355	$ 14,046	$ 754

Interest income on non-accrual loans is generally recognized on a cash basis and was approximately $1,000, $43,000 and $2,000 for the years ended December 31, 2019, 2018 and 2017.

7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

Troubled Debt Restructurings

There were no modifications made during the period ended December 31, 2019 and one modification made during the period ended December 31, 2018 that was considered a troubled debt restructuring. The modification of the terms of the loan in 2018 was a term out of a line of credit to an amortizing loan with a rate reduction. The loan had a pre-modification and post-modification outstanding recorded investment of $18,000. As of December 31, 2019 and 2018, the Company has a recorded investment in troubled debt restructurings of $5,970,000 and $6,642,000, respectively. The Company has allocated $78,000 and $185,000 of specific allowance for those loans at December 31, 2019 and 2018 and has not committed to lend additional amounts.

There were no payment defaults on troubled debt restructurings within 12 months following the modification during the year ended December 31, 2019 and 2018.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company's internal underwriting policy.

8. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following (dollars in thousands):

	December 31,	
	2019	2018
Land	$ 206	$ 206
Building and improvements	907	886
Furniture, fixtures and equipment	6,475	6,169
Leasehold improvements	1,739	1,721
	9,327	8,982
Less accumulated depreciation and amortization	(8,136)	(7,911)
	$ 1,191	$ 1,071

Depreciation and amortization included in occupancy and furniture and equipment expense totaled $226,000, $265,000 and $333,000 for the years ended December 31, 2019, 2018 and 2017, respectively.

9. INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following (dollars in thousands):

	December 31,	
	2019	2018
Savings	$ 75,820	$ 72,522
Money market	158,319	145,831
NOW accounts	69,834	69,489
Time, $250,000 or more	46,218	57,028
Other time	27,591	31,059
	$ 377,782	$ 375,929

The Company held $29,000,000 in certificates of deposit for the State of California as of December 31, 2019 and 2018. This amount represents 4.8% of total deposit balances at December 31, 2019 and 4.9% at December 31, 2018.

Aggregate annual maturities of time deposits are as follows (dollars in thousands):

Year Ending December 31,	
2020	$ 54,234
2021	8,064
2022	4,457
2023	4,988
2024	2,066
Thereafter	-
	$ 73,809

Interest expense recognized on interest-bearing deposits consisted of the following (dollars in thousands):

	Year Ended December 31,		
	2019	2018	2017
Savings	$ 28	$ 26	$ 22
Money market	548	257	123
NOW accounts	15	15	16
Time Deposits	1,487	1,061	694
	$ 2,078	$ 1,359	$ 855

10. BORROWING ARRANGEMENTS

The Company has $17,000,000 in unsecured short-term borrowing arrangements to purchase Federal funds with two of its correspondent banks. There were no advances under the borrowing arrangements as of December 31, 2019 and 2018.

In addition, the Company has a line of credit available with the FHLB which is secured by pledged mortgage loans (see Note 6) and investment securities (see Note 5). Borrowings may include overnight advances as well as loans with a term of up to thirty years. Advances totaling $19,500,000 were outstanding from the FHLB at December 31, 2019, bearing fixed interest rates ranging from 1.31% to 3.17% and maturing between January 1, 2020 and November 24, 2023. Advances totaling $15,500,000 were outstanding from the FHLB at December 31, 2018, bearing fixed interest rates ranging from 1.18% to 3.17% and maturing between April 30, 2019 and November 24, 2023. Amounts available under the borrowing arrangement with the FHLB at December 31, 2019 and 2018 totaled $143,406,000 and $107,262,000, respectively.

In addition, the Company entered into a secured borrowing agreement with the FRB in 2008. The borrowing arrangement is secured by pledging selected loans (see Note 6) and investment securities (see Note 5). There were no advances outstanding as of December 31, 2019 and 2018. Amounts available under the borrowing arrangement with the FRB at December 31, 2019 and 2018 totaled $8,642,000 and $8,340,000, respectively.

The following table summarizes these borrowings (dollars in thousands):

	December 31,			
	2019		2018	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate
Short-term portion of borrowings	$ 9,000	1.46%	$ 5,000	1.32%
Long-term borrowings	10,500	2.48%	10,500	2.02%
	$ 19,500	2.01%	$ 15,500	1.79%

Maturities on these borrowings are as follows (dollars in thousands):

Year Ending December 31,	
2020	$ 9,000
2021	2,000
2022	5,000
2023	3,500
Thereafter	-
	$ 19,500

11. INCOME TAXES

The provision for income taxes for the years ended December 31, 2019, 2018 and 2017 consisted of the following (dollars in thousands):

	Federal	State	Total
2019			
Current	$ 1,642	$ 1,001	$ 2,643
Deferred	(523)	(229)	(752)
Provision for income taxes	$ 1,119	$ 772	$ 1,891
2018			
Current	$ 733	$ 508	$ 1,241
Deferred	205	128	333
Provision for income taxes	$ 938	$ 636	$ 1,574
2017			
Current	$ 1,397	$ 608	$ 2,005
Deferred	1,222	25	1,247
Provision for income taxes	$ 2,619	$ 633	$ 3,252

11. INCOME TAXES (Continued)

Deferred tax assets (liabilities) consisted of the following (dollars in thousands):

	December 31, 2019	December 31, 2018
Deferred tax assets:		
Allowance for loan and lease losses	$ 1,548	$ 1,328
Unrealized losses on available-for-sale investment securities	-	788
Deferred compensation	1,899	1,695
Future state tax deduction	198	110
Premises and equipment	5	-
Lease liabilities	915	-
Other	72	47
Total deferred tax assets	4,637	3,968
Deferred tax liabilities:		
Deferred loan costs	(202)	(291)
Unrealized gains on available-for-sale investment securities	(752)	-
Federal Home Loan Bank stock dividends	(139)	(139)
Other real estate owned	(17)	(50)
Lease right of use asset	(850)	-
Premises and equipment	-	(24)
Total deferred tax liabilities	(1,960)	(504)
Net deferred tax assets	$ 2,677	$ 3,464

The Company and its subsidiaries file income tax returns in the United States and California jurisdictions. There are currently no pending federal, state or local income tax examinations by tax. Furthermore, with few exceptions, the Company is no longer subject to the examination by federal taxing authorities for the years ended before December 31, 2016 and by state and local taxing authorities for years before December 31, 2015. There were no unrecognized tax benefits accrued by the Company as of December 31, 2019. The Company does not expect to have a significant increase or decrease in unrecognized tax benefits in the next twelve months.

The provision for income taxes differs from amounts computed by applying the statutory Federal income tax rate of 21% in 2019 and 2018 and 34% in 2017 to income before income taxes. The significant items comprising these differences consisted of the following:

	Year Ended December 31, 2019	2018	2017
Federal income tax statutory rate	21.0%	21.0%	34.0%
State franchise tax, net of Federal tax effect	8.3%	8.1%	6.5%
Effect of Federal rate reduction on deferred tax assets	-	-	19.0%
Tax benefit of interest on loans to/investments in states and political subdivisions	(2.9)%	(3.3)%	(6.1)%
Tax-exempt income from life insurance policies	(1.0)%	(1.0)%	(1.7)%
Equity compensation expense	-	0.1%	0.1%
Other	0.2%	(0.6)%	(1.4)%
Effective tax rate	25.6%	24.3%	50.4%

12. COMMITMENTS, CONTINGENCIES AND CONCENTRATIONS OF CREDIT RISK

Leases

The Company adopted ASU 2016-02, *Leases (Topic 842),* on January 1, 2019, using the alternative transition method whereby comparative periods were not restated. No cumulative effect adjustment to the opening balance of retained earnings was required. The Company also elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things allowed the Company to carry forward the historical lease classifications. Additionally, the Company elected the hindsight practical expedient to determine the lease term for existing leases.

The Company leases nine locations for administrative offices and branch locations. All leases were classified as operating leases. Leases with an initial term of 12 months or less are not recorded on the balance sheet and the related lease expense is recognized on a straight-line basis over the lease term. The Company elected to use the practical expedient to not recognize short-term leases on the consolidated balance sheet and instead account for them as executory contracts.
Certain leases include options to renew, with renewal terms that can extend the lease term, typically for five years. One of the branch facilities is leased from a current member of the Company's Board of Directors (see Note 17). Lease assets and liabilities include related options that are reasonably certain of being exercised, however, in the case of those leases that have renewal options, the Company is not including those additional lease terms as the rates are undeterminable and it has been the Company’s historical practice to renegotiate lease terms upon expiration of the original lease terms. The depreciable life of leased assets is limited by the expected lease term.

Adoption of this standard resulted in the Company recognizing a right of use asset and a corresponding lease liability of $3,570,000 on January 1, 2019.

Supplemental lease information at or for the year ended December 31, 2019 is as follows:

Balance Sheet	
Operating lease asset classified as other assets	$ 2,875,000
Operating lease liability classified as other liabilities	3,098,000
Income Statement	
Operating lease cost classified as occupancy and equipment expense	$ 756,000
Weighted average lease term, in years	5.63
Weighted average discount rate*	2.97%
Operating cash flows	$ 754,000

*The discount rate was developed by using the fixed rate credit advance borrowing rate at the Federal Home Loan Bank of San Francisco for a term correlating to the remaining life of each lease.

A maturity analysis of the Company’s lease liabilities at December 31, 2019 was as follows:

	Balance
January 1, 2020 to December 31, 2020	$ 769,000
January 1, 2020 to December 31, 2021	739,000
January 1, 2021 to December 31, 2022	707,000
January 1, 2022 to December 31, 2023	282,000
January 1, 2023 to December 31, 2024	273,000
Thereafter	657,000
Total lease payments	3,427,000
Less: Interest	(329,000)
Present value of lease liabilities	$ 3,098,000

12. COMMITMENTS, CONTINGENCIES AND CONCENTRATIONS OF CREDIT RISK (Continued)

Leases (Continued)

Operating lease cost included in occupancy, furniture and equipment expense totaled $756,000, $753,000 and $755,000 for the years ended December 31, 2019, 2018 and 2017, respectively.

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 and to reduce its exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the consolidated balance sheet.

The Company's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and standby letters of credit as it does for loans included on the consolidated balance sheet. The following financial instruments represent off-balance-sheet credit risk (dollars in thousands):

	December 31,	
	2019	2018
Commitments to extend credit:		
Revolving lines of credit secured by 1-4 family residences	$ 41	$ 47
Commercial real estate, construction and land development commitments secured by real estate	22,508	21,185
Other unused commitments, principally commercial loans	17,775	13,044
	$ 40,324	$ 34,276
Standby letters of credit	$ 300	$ 361

At inception, real estate loan commitments are generally secured by property with a loan to value ratio of 55% to 75%. In addition, the majority of the Company's commitments have variable rates.

Commitments to extend credit are agreements to lend to a client as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Each client's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but may include accounts receivable, inventory, equipment and deeds of trust on real estate and income-producing commercial properties.

Standby letters of credit are conditional commitments issued to guarantee the performance or financial obligation of a client to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to clients.

Significant Concentrations of Credit Risk

The Company grants real estate mortgage, real estate construction, commercial, agricultural and consumer loans to clients throughout Northern California.

12. COMMITMENTS, CONTINGENCIES AND CONCENTRATIONS OF CREDIT RISK (Continued)

Significant Concentrations of Credit Risk (Continued)

In management's judgment, a concentration exists in real estate-related loans which represented approximately 81% of the Company's loan portfolio at December 31, 2019 and 87% at December 31, 2018. A continued substantial decline in the economy in general, or a continued decline in real estate values in the Company's primary market areas in particular, could have an adverse impact on collectability of these loans. However, personal and business income represents the primary source of repayment for a majority of these loans.

Correspondent Banking Agreements

The Company maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. The Company had $6,438,000 in uninsured deposits at December 31, 2019. The Company had $9,175,000 in uninsured deposits at December 31, 2018.

Contingencies

The Company is subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the consolidated financial position or results of operations of the Company.

13. SHAREHOLDERS' EQUITY

Earnings Per Share

A reconciliation of the numerators and denominators of the basic and diluted earnings per share computations is as follows (dollars and shares in thousands, except per share data):

For the Year Ended	Net Income	Weighted Average Number of Shares Outstanding	Per-Share Amount
December 31, 2019			
Basic earnings per share	$ 5,500	5,847	$ 0.94
Effect of dilutive stock-based compensation	-	22	
Diluted earnings per share	$ 5,500	5,869	$ 0.94
December 31, 2018			
Basic earnings per share	$ 4,900	5,871	$ 0.83
Effect of dilutive stock-based compensation	-	38	
Diluted earnings per share	$ 4,900	5,909	$ 0.83
December 31, 2017			
Basic earnings per share	$ 3,198	6,349	$ 0.50
Effect of dilutive stock-based compensation	-	78	
Diluted earnings per share	$ 3,198	6,427	$ 0.50

No shares were antidilutive for the year ended December 31, 2019 or for the year ended December 31, 2018. Stock options for 34,736 shares of common stock were not considered in computing diluted earnings per common share for the year ended December 31, 2017, because they were antidilutive.

Stock Based Compensation

On March 17, 2010, the Board of Directors adopted the 2010 Equity Incentive Plan (the "2010 Plan"). The 2010 Plan was approved by the Company's shareholders on May 20, 2010. At December 31, 2019, the total number of authorized shares that are available for issuance under the 2010 Plan is 1,269,229. The 2010 Plan provides for the following types of stock-based awards: incentive stock options; nonqualified stock options; stock appreciation rights; restricted stock; restricted performance stock; unrestricted Company stock; and performance units. The 2010 Plan, under which equity incentives may be granted to employees and directors under incentive and nonstatutory agreements, requires that the option price may not be less than the fair value of the stock at the date the option is granted. The option awards under the 2010 Plan expire on dates determined by the Board of Directors, but not later than ten years from the date of award.

13. SHAREHOLDERS' EQUITY (Continued)

Stock Based Compensation (Continued)

The vesting period is generally five years; however, the vesting period can be modified at the discretion of the Company's Board of Directors. Outstanding option awards under the 2010 Plan are exercisable until their expiration. The 2010 Plan does not provide for the settlement of awards in cash and new shares are issued upon exercise of an option.

There were no options granted in 2017, 2018 or 2019.

A summary of the outstanding and nonvested stock option activity for the year ended December 31, 2019 is as follows:

	Outstanding		Nonvested	
	Shares	Weighted Average Exercise Price Per Share	Shares	Weighted Average Grant Date Fair Value Per Share
Balance, January 1, 2019	41,098	$ 8.71	7,136	$ 2.94
Options granted	-	$ -	-	$ -
Options vested	-	$ -	(4,913)	$ 3.01
Options exercised	(11,140)	$ 8.50	-	$ -
Options expired or canceled	-	$ -	-	$ -
Balance, December 31, 2019	29,958	$ 8.79	2,223	$ 3.24

A summary of options as of December 31, 2019 is as follows:

Nonvested:	
Weighted average exercise price of nonvested stock options	$ 9.56
Aggregate intrinsic value of nonvested stock options	$ 11,804
Weighted average remaining contractual term in years of nonvested stock options	5.39
Vested:	
Number of vested stock options	27,735
Number of options expected to vest	2,223
Weighted average exercise price per share	$ 8.73
Aggregate intrinsic value	$ 170,293
Weighted average remaining contractual term in years	4.32

13. SHAREHOLDERS' EQUITY (Continued)

Stock Based Compensation (Continued)

Range of Exercise Prices	Number of Options Outstanding December 31, 2019	Weighted Average Remaining Contractual Life	Number of Options Exercisable December 31, 2019
\$7.07- \$8.73	5,402	2.38 years	5,402
\$8.74- \$9.56	24,556	4.85 years	22,333
	29,958		27,735

Restricted Stock

Restricted stock awards are grants of shares of the Company's common stock that are subject to forfeiture until specific conditions or goals are met. Conditions may be based on continuing employment or service and/or achieving specified performance goals. During the period of restriction, Plan participants holding restricted share awards have voting and cash dividend rights. The restrictions lapse in accordance with a schedule or with other conditions determined by the Board of Directors as reflected in each award agreement. Upon the vesting of each restricted stock award, the Company issues the associated common shares from its inventory of authorized common shares. All outstanding awards under the Plan immediately vest in the event of a change of control of the Company. The shares associated with any awards that fail to vest become available for re-issuance under the Plan. The following is a summary of stock-based compensation information as of or for the years ended December 31, 2019, 2018 and 2017:

There were 33,968 shares of restricted stock awarded during 2019. Of the 33,968 restricted common shares, 11,076 will vest one year from the date of the award, 18,394 will vest 33% per year from the date of the award, and 4,498 will vest 20% per year from the date of the award. The weighted average contractual term over which the restricted stock will vest is 2.62 years. There were 22,514 shares of restricted stock awarded during 2018. Of the 22,514 restricted common shares, 8,535 will vest one year from the date of the award, 11,599 will vest 33% per year from the date of the award, and 2,380 will vest 20% per year from the date of the award. The weighted average contractual term over which the restricted stock will vest is 2.45 years.

13. SHAREHOLDERS' EQUITY (Continued)

Restricted Stock (Continued)

Restricted Stock	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2019	32,528	$ 14.60
Awarded	33,968	$ 13.67
Vested	(17,867)	$ 14.60
Cancelled	(4,658)	$ 13.91
Nonvested at December 31, 2019	43,971	$ 13.95

The shares awarded to employees and directors under the restricted stock agreements vest on applicable vesting dates only to the extent the recipient of the shares is then an employee or a director of the Company or one of its subsidiaries, and each recipient will forfeit all of the shares that have not vested on the date his or her employment or service is terminated. New shares are issued upon vesting of the restricted common stock.

	2019	2018	2017
	(Dollars in thousands)		
Total intrinsic value of options exercised	$ 60	$ 137	$ 235
Aggregate cash received for option exercises	$ 95	$ 189	$ 351
Total fair value of options vested	$ 15	$ 14	$ 57
Total compensation cost, options and restricted stock	$ 338	$ 227	$ 273
Tax benefit recognized	$ 88	$ 53	$ 99
Net compensation cost, options and restricted stock	$ 250	$ 174	$ 174
Total compensation cost for nonvested option awards not yet recognized	$ 3	$ 17	$ 47
Weighted average years for compensation cost for nonvested options to be recognized	0.3	1.0	1.0
Total compensation cost for restricted stock not yet recognized	$ 394	$ 318	$ 284
Weighted average years for compensation cost for restricted stock to be recognized	0.8	0.8	1.1

The intrinsic value used for stock options and restricted stock awards was derived from the market price of the Company's common stock of $14.87 as of December 31, 2019.

Other Equity Awards

There were no stock appreciation rights, restricted performance stock, unrestricted Company stock, or performance units awarded during 2019 or 2018 or outstanding at December 31, 2019 or December 31, 2018.

Stock Repurchase Program

On January 24, 2018, the Company approved and authorized a stock repurchase program which authorized the repurchase during 2018 of up to 5% of the outstanding shares of the Company's common stock. During 2018, the Company repurchased 308,618 shares of its common stock at an average price of $15.52 per share. The Company did not repurchase shares of its common stock during 2019.

14. REGULATORY MATTERS

Dividends

Upon declaration by the Board of Directors of the Company, all shareholders of record will be entitled to receive dividends. In 2018 and 2017, the Company declared cash dividends in the amount of $0.05 per common share for each quarter, totaling $0.20 per common share for the years ended December 31, 2018 and 2017. The Company continued declaring cash dividends in the amount of $0.05 per common share for the first two quarters of 2019 and then increased it to $0.07 per common share for the final two quarters of the year, totaling $0.24 per share for the year ended December 31, 2019. There is no assurance, however, that any dividends will be paid in the future since they are subject to regulatory restrictions, and dependent upon earnings, financial condition and capital requirements of the Company and its subsidiaries.

As a California corporation, the Company’s ability to pay cash dividends is subject to restrictions set forth in the California General Corporation Law (the "Corporation Law"). The Corporation Law provides that neither a corporation nor any of its subsidiaries shall make a distribution to the corporation’s shareholders unless the board of directors has determined in good faith either of the following: (1) the amount of retained earnings of the corporation immediately prior to the distribution equals or exceeds the sum of (A) the amount of the proposed distribution plus (B) the preferential dividends arrears amount; or (2) immediately after the distribution, the value of the corporation’s assets would equal or exceed the sum of its total liabilities plus the preferential rights amount. The good faith determination of the board of directors may be based upon (1) financial statements prepared on the basis of reasonable accounting practices and principles, (2) a fair valuation, or (3) any other method reasonable under the circumstances; provided, that a distribution may not be made if the corporation or subsidiary making the distribution is, or is likely to be, unable to meet its liabilities (except those whose payment is otherwise adequately provided for) as they mature. The term "preferential dividends arrears amount" means the amount, if any, of cumulative dividends in arrears on all shares having a preference with respect to payment of dividends over the class or series to which the applicable distribution is being made, provided that if the articles of incorporation provide that a distribution can be made without regard to preferential dividends arrears amount, then the preferential dividends arrears amount shall be zero. The term "preferential rights amount" means the amount that would be needed if the corporation were to be dissolved at the time of the distribution to satisfy the preferential rights, including accrued but unpaid dividends, of other shareholders upon dissolution that are superior to the rights of the shareholders receiving the distribution, provided that if the articles of incorporation provide that a distribution can be made without regard to any preferential rights, then the preferential rights amount shall be zero.

14. REGULATORY MATTERS (Continued)

Dividends (Continued)

In addition, the California Financial Code restricts the total dividend payment of any state banking corporation in any calendar year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. In addition, subject to prior regulatory approval, any state banking corporation may request an exception to this restriction.

Regulatory Capital

The Company and ARB are subject to certain regulatory capital requirements administered by the Board of Governors of the Federal Reserve System and the FDIC. Failure to meet these minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, banks must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and American River Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. As of December 31, 2019 and 2018, the most recent regulatory notification categorized American River Bank as well capitalized under the regulatory framework for prompt corrective action plan. There are no conditions or events since that notification that management believes have changed the Bank's categories.

Effective January 1, 2015, bank holding companies with consolidated assets of $1 Billion or more ($3 Billion or more effective August 30, 2018) and banks like American River Bank must comply with new minimum capital ratio requirements to be phased-in between January 1, 2015 and January 1, 2019, which would consist of the following: (i) a new common equity Tier 1 capital to total risk weighted assets ratio of 4.5%; (ii) a Tier 1 capital to total risk weighted assets ratio of 6% (increased from 4%); (iii) a total capital to total risk weighted assets ratio of 8% (unchanged from current rules); and (iv) a Tier 1 capital to adjusted average total assets ("leverage") ratio of 4%.

In addition, a "capital conservation buffer," requires maintenance of a minimum of 2.5% of common equity Tier 1 capital to total risk weighted assets in excess of the regulatory minimum capital ratio requirements described above. The 2.5% buffer will increase the minimum capital ratios to (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. If the capital ratio levels of a banking organization fall below the capital conservation buffer amount, the organization will be subject to limitations on (i) the payment of dividends; (ii) discretionary bonus payments; (iii) discretionary payments under Tier 1 instruments; and (iv) engaging in share repurchases.

To be categorized as well capitalized, ARB must maintain minimum total risk-based, Tier 1 risk-based, common equity Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below.

Management believes that the Company and ARB met all their capital adequacy requirements as of December 31, 2019 and 2018.

14. REGULATORY MATTERS (Continued)

Regulatory Capital (Continued)

	December 31,					
	2019			2018		
	Amount		Ratio	Amount		Ratio
	(Dollars in thousands)					
Leverage Ratio						
American River Bankshares and Subsidiaries	$	64,796	9.2%	$	60,276	8.9%
American River Bank	$	65,467	9.3%	$	60,704	9.0%
Minimum requirement for "Well-Capitalized" institution	$	35,366	5.0%	$	33,700	5.0%
Minimum regulatory requirement*	$	45,975	6.5%	$	39,597	5.9%
Common Equity Tier 1 Risk-Based Capital Ratio						
American River Bank	$	65,467	14.9%	$	60,704	16.2%
Minimum requirement for "Well-Capitalized" institution	$	28,499	6.5%	$	24,307	6.5%
Minimum regulatory requirement*	$	30,691	7.0%	$	23,839	6.4%
Tier 1 Risk-Based Capital Ratio						
American River Bankshares and Subsidiaries	$	64,796	14.8%	$	60,276	16.1%
American River Bank	$	65,467	14.9%	$	60,704	16.2%
Minimum requirement for "Well-Capitalized" institution	$	35,076	8.0%	$	29,916	8.0%
Minimum regulatory requirement*	$	37,268	8.5%	$	29,449	7.9%
Total Risk-Based Capital Ratio						
American River Bankshares and Subsidiaries	$	69,934	15.9%	$	64,668	17.3%
American River Bank	$	70,605	16.1%	$	65,096	17.4%
Minimum requirement for "Well-Capitalized" institution	$	43,845	10.0%	$	37,395	10.0%
Minimum regulatory requirement*	$	46,037	10.5%	$	36,928	9.9%

* Ratio for regulatory requirement includes the capital conservation buffer of 2.50% as of December 31, 2019 and 1.875% as of December 31, 2018.

15. OTHER NONINTEREST INCOME AND EXPENSE

Other noninterest income consisted of the following (dollars in thousands):

	Year Ended December 31,		
	2019	2018	2017
Merchant fee income	$ 391	$ 422	$ 411
Increase in cash surrender value of life insurance policies (Note 16)	334	307	317
Other	290	277	242
	$ 1,015	$ 1,006	$ 970

Other noninterest expense consisted of the following (dollars in thousands):

	Year Ended December 31,		
	2019	2018	2017
Professional fees	$ 1,226	$ 1,158	$ 1,140
Outsourced item processing	322	315	319
Directors' expense	518	514	427
Telephone and postage	328	409	360
Stationery and supplies	138	140	135
Advertising and promotion	599	561	228
Other operating expenses	574	307	557
	$ 3,705	$ 3,404	$ 3,166

16. EMPLOYEE BENEFIT PLANS

American River Bankshares 401(k) Plan

The American River Bankshares 401(k) Plan has been in place since January 1, 1993 and is available to all employees. Under the plan, the Company will match 100% of each participant’s contribution up to 3% of annual compensation plus 50% of the next 2% of annual compensation. Employer Safe Harbor matching contributions are 100% vested upon entering the plan. The Company's contributions totaled $264,000, $230,000 and $196,000 for the years ended December 31, 2019, 2018 and 2017, respectively.

Employee Stock Purchase Plan

The Company contracts with an administrator for an Employee Stock Purchase Plan which allows employees to purchase the Company's stock at fair market value as of the date of purchase. The Company bears all costs of administering the Plan, including broker's fees, commissions, postage and other costs actually incurred.

16. EMPLOYEE BENEFIT PLANS (Continued)

American River Bankshares Deferred Compensation Plan

The Company has established a Deferred Compensation Plan for certain members of the management team and a Deferred Fee Agreement for Non-Employee Directors for the purpose of providing the opportunity for participants to defer compensation. Participants of the management team, who are selected by a committee designated by the Board of Directors, may elect to defer annually a minimum of $5,000 or a maximum of eighty percent of their base salary and all of their cash bonus. Directors may also elect to defer up to one hundred percent of their monthly fees. The Company bears all administration costs and accrues interest on the participants' deferred balances at a rate based on U.S. Government Treasury rates plus 4.0%. This rate was 6.51% and 6.20% for 2019 and 2018, respectively. Deferred compensation, including interest earned, totaled $3,274,000 and $3,211,000 at December 31, 2019 and 2018, respectively. The expense recognized under this plan totaled $210,000, $199,000 and $183,000 for the years ended December 31, 2019, 2018 and 2017, respectively.

Salary Continuation Plan

The Company has agreements to provide certain current executives, or their designated beneficiaries, with annual benefits for up to 15 years after retirement or death. These benefits are substantially equivalent to those available under life insurance policies purchased by the Company on the lives of the executives. The Company accrues for these future benefits from the effective date of the agreements until the executives' expected final payment dates in a systematic and rational manner. As of December 31, 2019 and 2018, the Company had accrued $1,391,000 and $1,402,000, respectively, for potential benefits payable. This payable approximates the then present value of the benefits expected to be provided at retirement and is included in accrued interest payable and other liabilities on the consolidated balance sheet. The expense recognized under this plan totaled $114,000, $85,000 and $234,000 for the years ended December 31, 2019, 2018 and 2017, respectively.

In connection with these current and former plans, the Company invested in single premium life insurance policies with cash surrender values totaling $15,763,000 and $15,429,000 at December 31, 2019 and 2018, respectively. Tax-exempt income on these policies, net of expense, totaled approximately $334,000, $307,000 and $317,000 for the years ended December 31, 2019, 2018 and 2017, respectively.

17. RELATED PARTY TRANSACTIONS

During the normal course of business, the Company enters into loan and deposit transactions with related parties, including Directors and affiliates. The following is a summary of the aggregate loan activity involving related party borrowers during 2019 (dollars in thousands):

Balance, January 1, 2019	$ 676
Disbursements	4,275
Amounts repaid	(120)
Balance, December 31, 2019	$ 4,831

There are no undisbursed commitments to related parties as of December 31, 2019.

The Company also leases one of its branch facilities from a current member of the Company's Board of Directors. Rental payments to the Director totaled $76,000 for each of the years ended December 31, 2019, 2018 and 2017, respectively.

18. PARENT ONLY CONDENSED FINANCIAL STATEMENTS

CONDENSED BALANCE SHEETS

December 31, 2019 and 2018
(Dollars in thousands)

	2019	2018
ASSETS		
Cash and due from banks	$ 97	$ 261
Investment in subsidiaries	83,580	75,149
Other assets	186	172
	$ 83,863	$ 75,582
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Other liabilities	$ 954	$ 861
Total liabilities	954	861
Shareholders' equity:		
Common stock	30,536	30,103
Retained earnings	50,581	46,494
Accumulated other comprehensive income (loss), net of taxes	1,792	(1,876)
Total shareholders' equity	82,909	74,721
	$ 83,863	$ 75,582

18. PARENT ONLY CONDENSED FINANCIAL STATEMENTS (Continued)

CONDENSED STATEMENTS OF INCOME

For the Years Ended December 31, 2019, 2018 and 2017
(Dollars in thousands)

	2019	2018	2017
Income:			
Dividends declared by subsidiaries – eliminated in consolidation	$ 1,505	$ 4,845	$ 11,118
Total income	1,505	4,845	11,118
Expenses:			
Professional fees	200	155	142
Directors' expense	374	361	282
Other expenses	231	218	226
Total expenses	805	734	650
Income before equity in undistributed income of subsidiaries	700	4,111	10,468
Equity in undistributed (dividends in excess of) income of subsidiaries	4,554	562	(7,554)
Income before income taxes	5,254	4,673	2,914
Income tax benefit	246	227	284
Net income	$ 5,500	$ 4,900	$ 3,198

18. PARENT ONLY CONDENSED FINANCIAL STATEMENTS (Continued)

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2019, 2018 and 2017
(Dollars in thousands)

	2019	2018	2017
Cash flows from operating activities:			
Net income	$ 5,500	$ 4,900	$ 3,198
Adjustments to reconcile net income to net cash provided by operating activities:			
(Equity in undistributed) dividends in excess of income of subsidiaries	(4,554)	(562)	7,554
Equity-based compensation expense	338	227	273
Increase in other assets	(223)	(10)	(95)
Increase (decrease) in other liabilities	93	(127)	(1)
Net cash provided by operating activities	1,154	4,428	10,929
Cash flows from financing activities:			
Proceeds from exercised options	95	189	351
Cash dividends paid	(1,413)	(1,188)	(1,293)
Cash paid to repurchase common stock	-	(4,773)	(8,641)
Net cash used in financing activities	(1,318)	(5,772)	(9,583)
Net (decrease) increase in cash and cash equivalents	(164)	(1,344)	1,346
Cash and cash equivalents at beginning of year	261	1,605	259
Cash and cash equivalents at end of year	$ 97	$ 261	$ 1,605

Selected Quarterly Information (Unaudited)

(In thousands, except per share and price range of common stock)

	March 31,	June 30,	September 30,	December 31,
2019				
Interest income	$ 6,132	$ 6,276	$ 6,555	$ 6,707
Net interest income	5,549	5,628	5,928	6,104
Provision for loan and lease losses	180	180	120	180
Noninterest income	411	421	417	439
Noninterest expense	4,260	4,148	4,093	4,345
Income before taxes	1,520	1,721	2,132	2,018
Net income	1,146	1,276	1,571	1,507
Basic earnings per share	$ 0.20	$ 0.22	$ 0.27	$ 0.26
Diluted earnings per share	0.20	0.22	0.27	0.26
Cash dividends per share	0.05	0.05	0.07	0.07
Price range, common stock	$12.01-15.00	$11.66-13.50	$12.04-13.98	$13.09-15.99
2018				
Interest income	$ 5,066	$ 5,498	$ 5,666	$ 6,012
Net interest income	4,737	5,120	5,257	5,532
Provision for loan and lease losses	-	-	50	125
Noninterest income	372	380	377	384
Noninterest expense	3,350	3,828	4,003	4,329
Income before taxes	1,759	1,672	1,581	1,462
Net income	1,353	1,269	1,153	1,125
Basic earnings per share	$ 0.23	$ 0.22	$ 0.20	$ 0.19
Diluted earnings per share	0.22	0.22	0.20	0.19
Cash dividends per share	0.05	0.05	0.05	0.05
Price range, common stock	$12.21-16.48	$14.95-17.50	$14.90-17.48	$10.50-15.65

American River Bankshares

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