

2009  
Annual Report



# 30 YEARS

## Celebrating 30 Years of Strong and Secure Banking.

With each passing year since our founding in 1980, it becomes more and more clear how Central Valley Community Bank has helped shape our industry and strengthen our region. It begins with our people – a team of local banking professionals with an in-depth understanding of our marketplace and the industries that call it home. It continues in our commitment to improving life in our communities, with Bank managers serving in over 80 different civic, health, education, art and philanthropic organizations. And it extends into our passion for helping businesses thrive, as the Bank has remained an active lender through good economies and bad. As we celebrate our 30th anniversary, we are humbled by how our communities have embraced the Bank over the years. As always, we remain committed to giving back, by consistently supporting worthwhile community organizations like those listed below.

### Community Partnerships

Ag Lenders Society of California  
Alegria Guild of Children's Hospital  
Alzheimer's Foundation of Central California  
American Cancer Society  
American Heart Association  
Boys & Girls Clubs of Fresno County  
Boys & Girls Clubs of Tracy  
Business Organization of Old Town Clovis  
CalCPA  
California Armenian Home  
California State University, Fresno Alumni Association  
California State University, Fresno Association  
California State University, Fresno Craig School of Business  
California State University, Fresno Foundation  
California State University, Fresno Maddy Institute  
Camp Sunshine Dreams  
Cen Cal Business Finance Group  
Central Valley Business Incubator  
Central Valley Christian Molokan School  
Children's Hospital Central California  
Chowchilla Little League Baseball  
Clovis District Chamber of Commerce  
Clovis Rodeo Association  
Clovis Rotary Club  
Court Appointed Special Advocates of Fresno & Madera Counties  
Doug McDonald Scholarship  
Downtown Association of Fresno  
Economic Development Corporation Serving Fresno County  
Fresno Area Down Syndrome Society  
Fresno Business Council  
Fancher Creek Elementary School  
Foundation for Clovis Schools  
Fresno Area Crime Stoppers  
Fresno Art Museum  
Fresno City & County Historical Society  
Fresno County 4-H Club  
Fresno County Community Food Bank  
Fresno Metropolitan Museum of Art  
Fresno Sunrise Rotary  
Fresno West Coalition for Economic Development  
Girl Scouts of Central California South  
Give Every Child A Chance  
GL Bruno Family Foundation  
Greater Fresno Area Chamber of Commerce  
Hinds Hospice  
Hospice of San Joaquin Butterfly Auxiliary  
Houghton Kearney Elementary School  
Junior Achievement  
Kerman 4-H Club  
Kerman Chamber of Commerce  
Kerman Community Food Bank  
Kerman Christian School  
Kerman High School  
Kerman Rotary Club  
Kerman Senior Advisory Board  
Knights of Columbus  
Latino Businessmen Association Foundation  
Leadership Fresno  
Lodi Cancer Kids  
Madera Chamber of Commerce  
Madera Community Hospital Foundation  
Make-A-Wish Foundation  
Marjaree Mason Center  
Merced County Chamber of Commerce  
Merced Police Officers Association  
Muscular Dystrophy Association  
National Breast Cancer Foundation  
North Fork Chamber of Commerce  
North Valley Soccer Club  
Oakhurst Area Chamber of Commerce  
Oakhurst Sierra Sunrise Rotary  
Omega Nu of Lodi  
Rotary Club of Auberry Intermountain  
Rotary Club of Fresno  
San Joaquin College of Law  
San Joaquin Nisei Farmers League  
San Joaquin River Parkway and Conservation Trust  
San Joaquin Tranquility Lions Club  
Scottish Rite Childhood Language Disorder Center  
Sequoia Council of the Boy Scouts of America  
Share Homes Adoption and Foster Care Agency  
Sherriff's Foundation for Public Safety  
Sierra Ag Boosters  
Sierra Mountain Little League  
Sierra Oaks Senior Citizens Association  
Sounds of Freedom – USMC Band Concert  
Spirit of Women  
State Center Community College District  
Stockton Athletic Hall of Fame  
Sunnyside High School  
The Bulldog Foundation  
The Fresno Bee – Newspapers In Education  
The Pop Laval Foundation  
The Salvation Army  
Tracy Chamber of Commerce  
Tracy Crush Soccer Team  
Tree Fresno  
Triple X Fraternity  
Toys For Tots Foundation  
United Way of Fresno County  
Women's Center of San Joaquin County  
Yosemite Lakes Park Volunteer Fire Department



## To Our Shareholders



**Daniel N. Cunningham**  
*Director, Quinn Group, Inc.  
Founding Director and Chairman of the Board  
Central Valley Community Bancorp*

**Daniel J. Doyle**  
*President, CEO and Director  
Central Valley Community Bancorp  
Central Valley Community Bank*

### *A Challenging Year For The Nation And Its Banks*

The best thing we can say about 2009 is that it's finally behind us! The year was marked by a crippling economic recession and record unemployment, the highest right here in California's Central Valley, our primary market. The continuing decline in real estate values, the dramatic rise in foreclosures and bankruptcies, the significant Federal and State deficits, the closing of over 140 banks with another 400 considered "troubled" – all of these led to challenges for our customers and, therefore, challenges for the Company. Yet despite these challenges, Central Valley Community Bancorp was able to show profits in each quarter of 2009 as well as for the full year. Considering that more than half of California's 330 banks did not show a profit in 2009 at all, it's clear that we performed better than most of our peers in all key performance areas.

### *Sound Decisions Allow Growth, Lending & Confidence*

The year began with participation in the TARP Capital Purchase Program, in which the Company sold \$7 million in Preferred Stock (the minimum allowed for a bank our size) on January 30, 2009, to the US Treasury. This signaled to the markets and customers that we were considered a strong institution, with the financial strength and management expertise to survive this severe economic environment. We also felt that the additional capital would help us through the financial uncertainty and replace some of the capital used to acquire Service 1st Bank in 2008. Additionally, we believed that increasing capital would allow us to consider opportunities that might present themselves as the year progressed.

Little did we know that the "rules" would change – that the media, Congress and Administration would portray this acceptance of funds from the US Treasury as a "bailout" rather than a means of stabilizing the financial sector.

Despite the political fallout, having the additional capital allowed the Company to continue to grow, to lend to creditworthy customers and to help our communities. In addition, we raised \$7.8 million in capital through a private placement on December 23, 2009, to once again provide financial strength and allow us to take advantage of growth opportunities that may come in 2010 and beyond. A noteworthy benefit of the new capital is that it will allow the Company to pay off the TARP CPP funds if we so choose, and eliminate one half of the warrants provided to the US Treasury as part of the pricing for that transaction. The price of the Company's stock, like that of many in the financial sector, hit bottom at the end of the first quarter 2009 and has slowly worked its way back up, but still not to the levels of previous years. However, the confidence from our ability to sell new stock and outperform our peers has caused Investor Analysis to list our stock as a "buy" and Sandler O'Neill + Partners, L.P. to name the Company's stock as one of the Top Investment Ideas for 2010.

### *A Year Of Growth And Honors*

Despite struggling with the quality of the loans in our portfolio and working with the borrowers to help them survive, we were still able to make progress toward the Company's long term strategic growth goals. At a time of market unrest from the closure of a significant Merced-based community bank, we opened a new full-service office in Merced, staffed with six professional bankers, to help fill a geographic gap and support this important Central Valley community. In addition, we relocated the Oakhurst office to a newly constructed location more visible and convenient for that community. The Bank was honored by once again being named one of the Best Companies to Work For in 2009 in Central California's six county region – the only bank in the large-size business category of a 100 or more employees, and the only public company to receive this honor. We also kicked off an anniversary celebration in 2010, honoring our 30-year history of proudly serving the Central Valley.

### *More Protection & Convenience For Our Customers*

To assure the valued customers of the safety and soundness of their deposits with Central Valley Community Bank, we have chosen to participate in the extension of 100% FDIC Insurance coverage on non interest bearing checking accounts and certain covered Money Market Accounts through June 30, 2010. At the same time, the Federal Reserve Bank has dictated new rules and regulations that will take effect in June 2010, pertaining to the Bank's ability to protect its customers from overdrafts created by ATM and electronic funds transactions. We will give our customers the ability to receive these valuable services if they choose to opt-in for this protection. Additionally, Cash Management services for our business customers are being updated and expanded, and Online Banking and Bill Pay services will be enhanced by the end of this year.

### *Remaining Strong For Our Community*

The markets we serve in the Central Valley have been some of the hardest hit with declining real estate values, rising unemployment, increased bankruptcy, decreased sales, falling commodity prices, a serious politically-charged water shortage and rising vacancy rates in commercial real estate. While interest rates have remained low for borrowers, little demand has been seen, as consumers and businesses continue to reduce debt and remain uncertain about where the economy is headed and how they may be impacted by higher taxes or other negative government regulations. By adding capital to the Company and remaining profitable, we continue to increase our capital ratios considerably above the levels required to be considered well-capitalized by the regulators. The Federal Reserve has driven rates down significantly over the past couple of years, which has decreased the rates paid to depositors and charged to borrowers. Fortunately, one of the strengths of our Company continues to be a strong net interest margin and low cost of funds.

### *Encouraging Earnings & Financial Performance*

With the credit challenges faced by our Company and the financial industry, we added more than \$10 million to the provision for credit losses, and had charge offs of 1.56% of the total loan portfolio. The non performing loans grew to levels we have not seen since the mid-1990s, but our numbers were better than most of our peers. Through the diversification and discipline we use in managing our Bank, as well as strong and dedicated customers, we have been able to outperform most of our peers throughout this recession. This is evidenced by the recognition we received from the Findley Reports in 2009, which named ours as the "Exceptional Bank" in California among those with \$600 million to \$1.2 billion in assets.

### *Strong Despite Banking Industry Changes*

We continue to see bank closures across the country, and projections show more banks being closed in 2010 than the 140 closures in 2009. Congress and financial regulators are weighing the changes that will be put in place, many of which – if enacted as discussed – will stifle entrepreneurship and creativity in the banking system, while adding costs to

already heavily-regulated banks like Central Valley Community Bank. FDIC premiums paid by banks to provide deposit insurance for their customers have increased, and a prepayment of three years was assessed on the banking system in December 2009. We realize we are not yet through this recession, and that our citizens must find meaningful employment and confidence in the future. Still, there is reason to be encouraged. Our country's banking system in general, and Central Valley Community Bank in particular, are still financially strong and working to provide support to help our communities, businesses, nonprofit organizations and individuals as opportunities present themselves. Additionally, with our CEO Dan Doyle currently serving as Chairman of the Board of Directors for the California Bankers Association, we benefit by sharing our viewpoint on a statewide and national level and gaining knowledge that will aid in the guidance of our Bank.

### *The Outlook For 2010*

While we believe the worst of the recession is over, the recovery will not be rapid and job creation will be critical to helping rebuild communities and lives. Our Company is a proven survivor, has a strong financial position in the markets we serve, and is able to provide all the critical banking products with in-depth knowledge of local markets and industries. We will continue to look for opportunities to grow our business profitably and provide training for our dedicated team members, ensuring the ability to grow with our loyal customer base and ensure future success.

We are very proud of our team of bankers and their desire to meet the short- and long-term financial goals of our customers. This dedication has been built over our 30-year history of serving our communities with strong, secure banking, and comes from the leadership of our Board of Directors and senior management team through the years. While we are saddened to have recently lost David Cook, one of our founding Board members who served the Bank for 22 years as a Director until 2002, we are encouraged to have a team that continues to stand ready to provide the highest level of service and dedication. Together, we remain committed to creating shareholder value, serving our communities and carrying on our 30-year legacy, each and every day.



Daniel N. Cunningham  
Chairman of the Board



Daniel J. Doyle  
President and Chief Executive Officer



## A 30-Year Tradition of Service and Dedication

Central Valley Community Bancorp (the “Company”) was established as the holding company for Central Valley Community Bank (“CVCB”) on November 15, 2000, and is registered as a bank holding company with the Board of Governors of the Federal Reserve System. The Company currently conducts no operations other than through its ownership of the Bank. The common stock of the Company trades on the NASDAQ stock exchange under the symbol CVCY.

### *A Strong History of Steady Growth*

Central Valley Community Bank, founded in 1979 as Clovis Community Bank, is a California State chartered bank with deposit accounts insured by the Federal Deposit Insurance Corporation (FDIC). The Bank commenced operations on January 10, 1980, in Clovis, California, with 12 professional bankers and beginning assets of \$2,000,000. Currently, CVCB operates 16 full-service offices in Clovis, Fresno, Kerman, Lodi, Madera, Merced, Oakhurst, Prather, Sacramento, Stockton and Tracy, one loan production office in Modesto, plus Commercial, Real Estate, SBA and Agribusiness Lending Departments. Investment services are provided by Investment Centers of America, and Central Valley Community Insurance Services, LLC, provides financial and insurance solutions for businesses. Now with over 200 employees and assets of over \$765,000,000 as of December 31, 2009, Central Valley Community Bank has grown into a well-capitalized institution, with a proven track record of financial strength, security and stability. Yet despite the Bank’s growth, it has remained true to its original “roots” – a commitment to its core values of integrity, trustworthiness, caring, loyalty, leadership and teamwork.

Central Valley Community Bank distinguishes itself from other financial institutions through its 30-year track record of strength, security, client advocacy and the unchanged values that have guided the Bank since its opening. The Bank’s unique brand of personalized service has expanded as the operation has strategically grown throughout the San Joaquin Valley. Guided by a hands-on Board of Directors and a seasoned senior management team, CVCB continues to focus on personalized service and customer and employee satisfaction. The Bank has remained committed to the ongoing addition and retention of high-quality employees, as evidenced in 2009 by being named by the Business Journal as one of the “Best Companies to Work For” among companies with 100 or more employees throughout Central California’s six-county region. Additionally, The Findley Reports designated CVCB an “Exceptional Bank” in 2009 based on 2008 financial performance – the only California bank honored in the category of “\$600 Million to \$1.2 Billion in Assets.”

### *Unparalleled Protection, Unbeatable Convenience*

Central Valley Community Bank maintains state-of-the-art data processing and information systems, and offers a complete line of competitive business and personal deposit and loan products. Through powerful FDIC insurance, customer deposits for all insurable accounts are protected up to \$250,000 through December 31, 2013, and as of January 1, 2014, will return to \$100,000 per depositor for all account ownership categories except Certain Retirement Accounts, which will remain at \$250,000. Additionally, CVCB is participating in the FDIC’s Transaction Account Guarantee Program, offering unlimited FDIC insurance coverage for all personal and business non-interest bearing deposits, CVCB’s 100% Guaranteed Checking Account and Insurance on Lawyers Trust Accounts (IOLTA’s) through June 30, 2010. This coverage is in addition to the protection available under the FDIC’s general deposit insurance rules and unique to banks that have elected to participate. For maximum convenience, online banking, bill pay and a full range of cash management and remote deposit services are available at [www.cvcb.com](http://www.cvcb.com). In addition, ATMs are available around the clock at most CVCB offices, BankLine provides 24-hour telephone banking, and extended days and banking hours are offered at select CVCB offices.

### *“Success Built On “Relationship Banking”*

Central Valley Community Bank has built a reputation for superior banking service by offering personalized “relationship banking” for businesses, professionals and individuals. Serving the business community has always been a primary focus for the Bank, which continues to expand its commercial banking team to serve even more customers. The Bank’s experienced local banking professionals live and work in the local community, and have a deep understanding of the marketplace and industry. As a result, CVCB has remained an active business lender, helping San Joaquin Valley businesses to thrive even in the toughest economic times. Business customers are further served by courier service, adding another level of personal service and convenience.

The Bank is committed to increasing and enhancing its products and services, while emphasizing needs-based consulting within the branch environment. Serving both new and long-time customers

continues to be an important factor in the Bank's growth, as demonstrated in ongoing customer referrals. Dependable values and security have always been important to California's banking customers, and CVCB is well-positioned to provide them, with an ongoing emphasis on privacy, safety and convenience.

#### *Leadership Fully Invested In The Community*

The Bank is focused not only on individual customers, but also on investing in the communities it serves. Each year, the Bank donates time, expertise and financial support to a wide variety of local charities and philanthropies. Additionally, the Bank's management currently serves in 80 different civic, health,

education, art and philanthropic organizations throughout the Valley. This includes President & CEO Dan Doyle, who also serves as Chairman of the Board for the California Bankers Association, among many other organizations.

#### *A Proud Past, A Promising Future*

Thanks to the vision of Central Valley Community Bancorp, as well as the leadership of its Board of Directors, CVCB has grown steadily and sensibly over the past 30 years, keeping pace with the needs of its customers and the communities it serves. All while retaining the local leadership and values that formed the Bank's firm foundation. Central Valley Community Bank. Strong. Solid. Unchanging Values.



Central Valley Community Bank Senior Management

From Left: David Kinross, Thomas Sommer, Lydia Shaw, Daniel Doyle, Bryan Hyzdu and Gary Quisenberry

### **Mission Statement**

As A Full Service Bank, We Are Committed To:

Providing a full range of financial services desired by our customers, while providing superior customer service delivered in a highly professional and personal manner

Maintaining a positive work environment and investing in each individual to "be the best they can be"

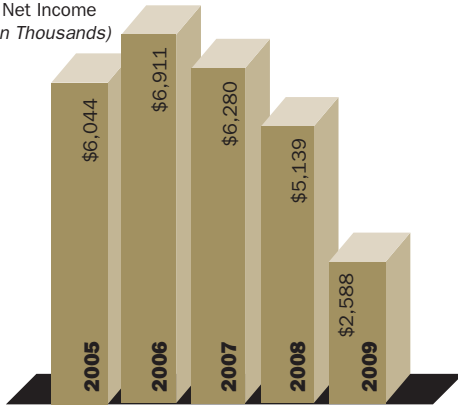
Contributing to the quality of life in the communities we serve

Continuing to maximize shareholder value

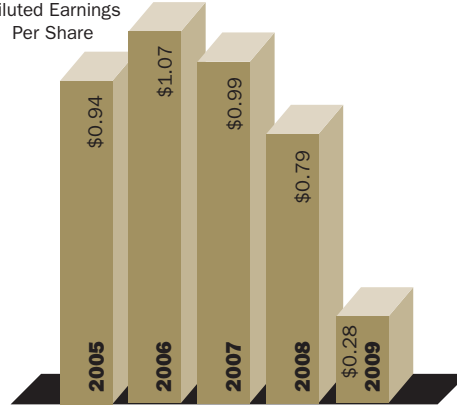
Being the "Bank of Choice" for customers and employees!

# Central Valley Community Bancorp Trend Analysis

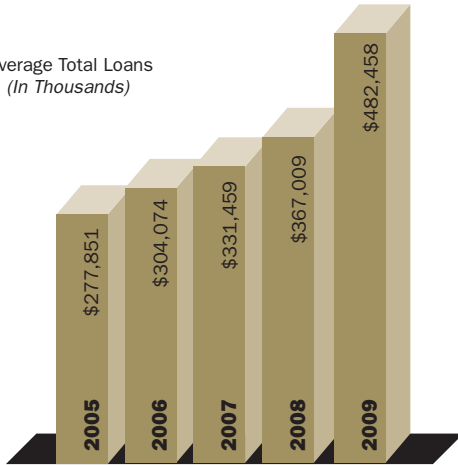
Net Income  
(In Thousands)



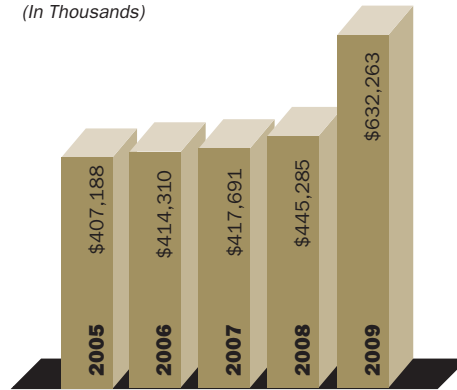
Diluted Earnings  
Per Share



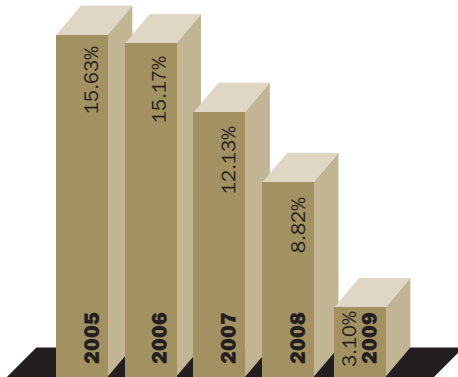
Average Total Loans  
(In Thousands)



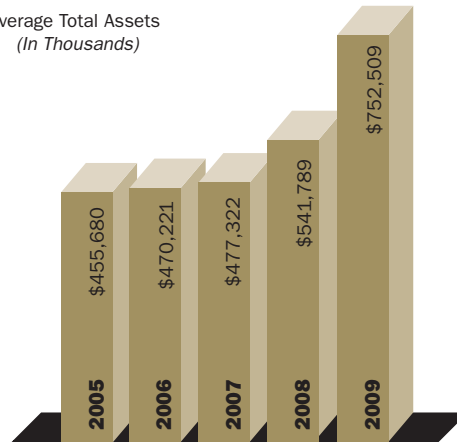
Average Total Deposits  
(In Thousands)



Return on  
Shareholders' Equity

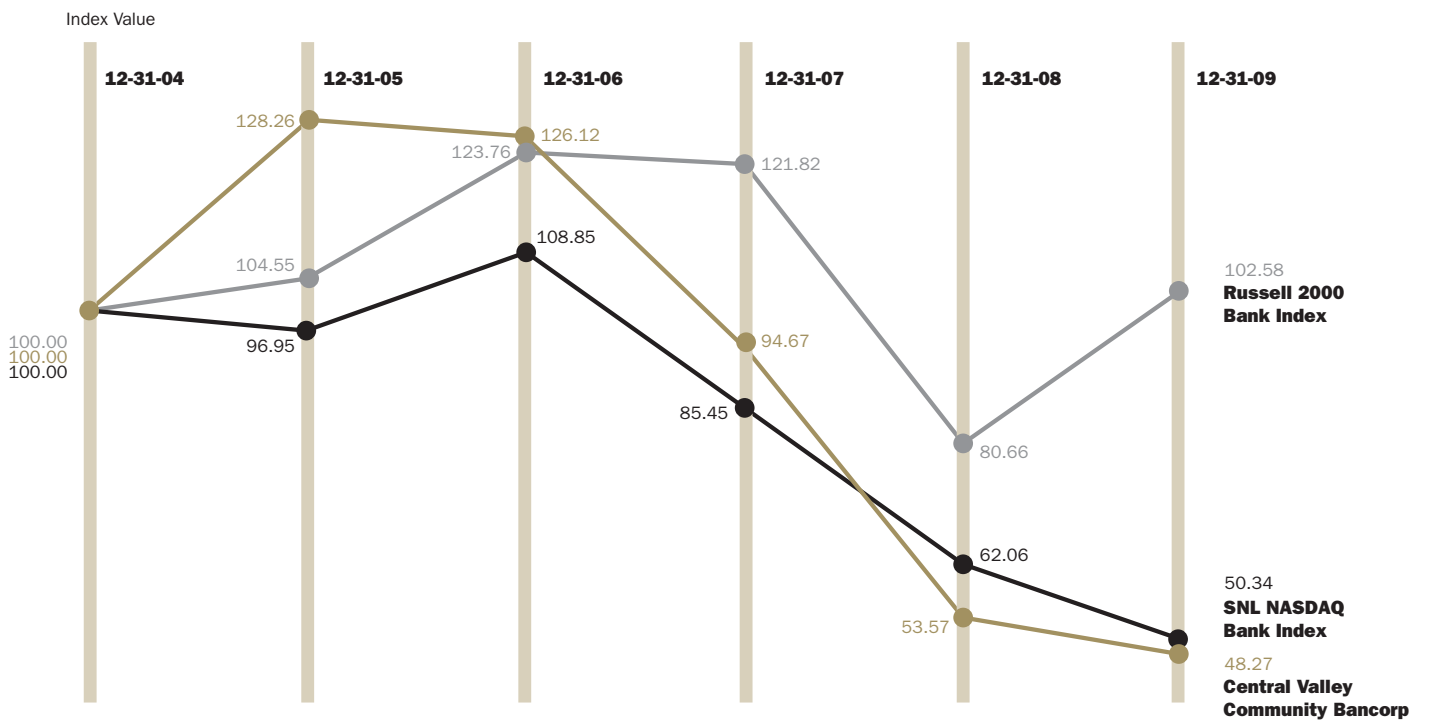


Average Total Assets  
(In Thousands)



# Central Valley Community Bancorp Comparative Stock Price Appreciation

## Total Return Performance



Note: The stock price performance shown in the graphs above should not be indicative of potential future stock price performance.

Source: SNL Financial LC



## CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY CONSOLIDATED BALANCE SHEETS

December 31, 2009 and 2008  
(In thousands, except share amounts)

	2009	2008
<b>ASSETS</b>		
Cash and due from banks	\$ 13,857	\$ 18,061
Interest-earning deposits in other banks	34,544	-
Federal funds sold	279	1,457
Total cash and cash equivalents	48,680	19,518
Investment securities:		
Available-for-sale, at fair value	197,319	185,718
Held-to-maturity, at amortized cost	-	7,040
Loans, less allowance for credit losses of \$10,200 at December 31, 2009 and \$7,223 at December 31, 2008	449,007	477,015
Bank premises and equipment, net	6,525	6,900
Other real estate owned	2,832	-
Bank owned life insurance	10,998	10,808
Federal Home Loan Bank stock	3,140	3,140
Goodwill	23,577	23,773
Core deposit intangibles	1,612	2,026
Accrued interest receivable and other assets	21,798	16,775
Total assets	\$ 765,488	\$ 752,713
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits:		
Non-interest bearing	\$ 159,630	\$ 162,106
Interest bearing	480,537	472,952
Total deposits	640,167	635,058
Short-term borrowings	5,000	6,368
Long-term debt	14,000	19,000
Junior subordinated deferrable interest debentures	5,155	5,155
Accrued interest payable and other liabilities	9,943	11,757
Total liabilities	674,265	677,338
Commitments and contingencies (Note 11)		
Shareholders' equity:		
Preferred stock, no par value; \$1,000 per share liquidation preference; 10,000,000 shares authorized:		
Series A, no par value, 7,000 shares issued and outstanding	6,819	-
Series B, no par value, 1,359 shares issued and outstanding	1,317	-
Common stock, no par value; 80,000,000 authorized; issued and outstanding 8,949,754 at December 31, 2009 and 7,642,280 at December 31, 2008	37,611	30,479
Retained earnings	46,931	44,708
Accumulated other comprehensive (loss) income, net of tax	(1,455)	188
Total shareholders' equity	91,223	75,375
Total liabilities and shareholders' equity	\$ 765,488	\$ 752,713

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

## CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31, 2009, 2008 and 2007  
(In thousands, except per share amounts)

	2009	2008	2007
Interest income:			
Interest and fees on loans	\$ 29,920	\$ 25,631	\$ 27,748
Interest on Federal funds sold	48	251	583
Interest and dividends on investment securities:			
Taxable	7,709	4,845	3,355
Exempt from Federal income taxes	3,057	1,118	880
Total interest income	40,734	31,845	32,566
Interest expense:			
Interest on deposits	5,867	6,340	7,894
Interest on junior subordinated deferrable interest debentures	129	46	-
Other borrowings	631	892	164
Total interest expense	6,627	7,278	8,058
Net interest income before provision for credit losses	34,107	24,567	24,508
Provision for credit losses	10,514	1,290	480
Net interest income after provision for credit losses	23,593	23,277	24,028
Non-interest income:			
Service charges	3,509	3,350	2,859
Appreciation in cash surrender value of bank owned life insurance	391	268	226
Loan placement fees	231	111	185
Net realized gains on sales and calls of investment securities	466	165	63
Federal Home Loan Bank dividends	7	118	102
Other income	1,246	1,178	1,083
Total non-interest income	5,850	5,190	4,518
Non-interest expenses:			
Salaries and employee benefits	13,926	11,578	10,829
Occupancy and equipment	3,812	2,890	2,618
Regulatory assessments	1,604	330	109
Data processing expense	1,316	848	847
Advertising	722	500	481
Audit and accounting fees	503	390	382
Other real estate owned expense	479	-	-
Loss on sale of assets	55	-	-
Other expense	5,114	4,440	3,833
Total non-interest expenses	27,531	20,976	19,099
Income before provision for income taxes	1,912	7,491	9,447
(Benefit) provision for income taxes	(676)	2,352	3,167
Net income	\$ 2,588	\$ 5,139	\$ 6,280
Net income	\$ 2,588	\$ 5,139	\$ 6,280
Preferred stock dividends and accretion of discount	365	-	-
Net income available to common shareholders	\$ 2,223	\$ 5,139	\$ 6,280
Basic earnings per share	\$ 0.29	\$ 0.83	\$ 1.05
Diluted earnings per share	\$ 0.28	\$ 0.79	\$ 0.99
Cash dividends per share	\$ -	\$ 0.10	\$ 0.10

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

## CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Years Ended December 31, 2009, 2008 and 2007  
(In thousands, except share and per share amounts)

	Preferred Stock		Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss) (Net of Taxes)	Total Shareholders' Equity	Total Comprehensive Income
	Shares	Amount	Shares	Amount				
Balance, January 1, 2007	-	\$ -	6,037,656	\$ 14,007	\$ 35,888	\$ (117)	\$ 49,778	
Comprehensive income:								
Net income	-	-	-	-	6,280	-	6,280	\$ 6,280
Other comprehensive income, net of tax:								
Net change in unrealized (loss) gain on available-for-sale investment securities	-	-	-	-	-	257	257	257
Total comprehensive income	-	-	-	-	(595)	-	(595)	\$ 6,537
Cash dividend payment (\$0.10 per share)	-	-	-	-	(1,090)	-	(2,707)	
Repurchase and retirement of common stock	-	-	(186,800)	(1,617)	-	-	221	
Stock-based compensation expense	-	-	-	221	-	-	960	
Stock options exercised and related tax benefit	-	-	124,460	-	-	-	-	
Balance, December 31, 2007	-	-	5,975,316	\$ 13,571	\$ 40,483	\$ 140	\$ 54,194	
Comprehensive income:								
Net income	-	-	-	-	5,139	-	5,139	\$ 5,139
Other comprehensive income, net of tax:								
Net change in unrealized gain on available-for-sale investment securities	-	-	-	-	-	48	48	48
Total comprehensive income	-	-	-	-	(598)	-	(598)	\$ 5,187
Cash dividend payment (\$0.10 per share)	-	-	-	-	-	-	(56)	
Repurchase and retirement of common stock	-	-	(5,436)	(56)	-	-	16,600	
Stock issued for acquisition	-	-	1,628,397	100	-	-	100	
Stock-based compensation expense	-	-	-	264	-	-	264	
Stock options exercised and related tax benefit	-	-	44,003	-	-	-	(316)	
Cumulative effect of adopting ASC 715-60 (previously EITF 06-04)	-	-	-	-	-	-	188	
Balance, December 31, 2008	-	-	7,642,280	\$ 30,479	\$ 44,708	\$ 188	\$ 75,375	

(Continued)

# CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Continued)

For the Years Ended December 31, 2009, 2008 and 2007  
(In thousands, except share and per share amounts)

	Preferred Stock		Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss) (Net of Taxes)	Total Shareholders' Equity	Total Comprehensive Income
	Shares	Amount	Shares	Amount				
Balance, December 31, 2008	-	\$ -	7,642,280	\$ 30,479	\$ 44,708	\$ 188	\$ 75,375	
Comprehensive income:								
Net income	-	-	-	-	2,588	-	2,588	\$ 2,588
Other comprehensive income, net of tax:								
Net change in unrealized gain (loss) on available-for-sale investment securities	-	-	-	-	-	(1,643)	(1,643)	(1,643)
Total comprehensive income	-	-	-	-	-	-	-	\$ 945
Issuance of preferred stock Series A, net of discount	7,000	6,775	-	-	-	-	6,775	
Issuance of preferred stock Series B, net of issuance costs	1,359	1,317	-	-	-	-	1,317	
Issuance of common stock, net of issuance costs	-	-	1,264,952	6,441	-	-	6,441	
Issuance of common stock warrants	-	-	-	225	-	-	225	
Stock-based compensation expense	-	-	-	284	-	-	284	
Stock options exercised and related tax benefit	-	-	42,522	182	-	-	182	
Preferred stock dividends and accretion of discount	-	44	-	-	(365)	-	(321)	
Balance, December 31, 2009	8,359	\$ 8,136	8,949,754	\$ 37,611	\$ 46,931	\$ (1,455)	\$ 91,223	

Disclosure of reclassification amount, net of taxes:

	2009	2008	2007
Unrealized holding (losses) gains arising during the year	\$ (1,183)	\$ 147	\$ 295
Less reclassification adjustment for net gains included in net income	(460)	(92)	(38)
Net change in unrealized (losses) gains on available-for-sale investment securities	\$ (1,643)	\$ 48	\$ 257

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

## CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2009, 2008 and 2007  
(In thousands)

	2009	2008	2007
Cash flows from operating activities:			
Net income	\$ 2,588	\$ 5,139	\$ 6,280
Adjustments to reconcile net income to net cash provided by operating activities:			
Net increase (decrease) in deferred loan fees	174	(370)	(164)
Depreciation	1,367	1,028	935
Accretion	(2,300)	(741)	(422)
Amortization	918	527	564
Stock-based compensation	284	100	221
Tax benefit from exercise of stock options	(7)	(57)	(395)
Provision for credit losses	10,514	1,290	480
Net realized gains on sales and calls of available-for-sale investment securities	(942)	(165)	(63)
Net realized losses on sales of held-to-maturity investment securities	176	-	-
Other than temporary impairment losses on investment securities	300	-	-
Net gain on sale and disposal of equipment	55	-	-
Increase in bank owned life insurance, net of expenses	(190)	(269)	(226)
Write down of other real estate owned	356	-	-
FHLB stock dividends	-	(118)	(102)
Net (increase) decrease in accrued interest receivable and other assets	(1,106)	(426)	645
Net increase in prepaid FDIC assessments	(3,740)	-	-
Net (decrease) increase in accrued interest payable and other liabilities	(2,259)	294	525
Provision for deferred income taxes	788	(556)	(403)
Net cash provided by operating activities	6,976	5,676	7,875
Cash flows from investing activities:			
Cash and cash equivalents acquired in acquisition	-	2,132	-
Purchases of available-for-sale investment securities	(82,178)	(57,484)	(20,693)
Purchases of held-to-maturity investment securities	(410)	(7,466)	-
Proceeds from principle repayments of held-to-maturity investment securities	2,793	501	-
Proceeds from sales or calls of available-for-sale investment securities	40,407	12,327	15,700
Proceeds from calls of held-to-maturity investment securities	1,474	-	-
Proceeds from maturity of available-for-sale investment securities	2,923	9,000	10,499
Proceeds from principal repayments of available-for-sale investment securities	29,954	18,525	14,608
Net decrease in interest bearing deposits in other banks	-	-	323
Proceeds from bank owned life insurance	430	-	-
Net FHLB stock purchases	-	-	(29)
Net decrease (increase) in loans	14,379	(24,666)	(18,704)
Purchases of premises and equipment	(991)	(1,092)	(2,047)
Proceeds from sale of equipment	-	-	4
Purchases of bank owned life insurance	-	-	(351)
Net cash provided by (used in) investing activities	8,781	(48,223)	(690)
Cash flows from financing activities:			
Net increase (decrease) in demand, interest-bearing and savings deposits	16,415	26,676	(45,523)
Net (decrease) increase in time deposits	(11,306)	12,332	7,458
Proceeds from issuance of Series A preferred stock and warrants	7,000	-	-
Net proceeds from issuance of Series B preferred stock	1,317	-	-
Net proceeds from issuance of common stock	6,441	-	-
Proceeds from short-term borrowings from Federal Home Loan Bank	10,000	135,500	87,500
Proceeds from long-term borrowings from Federal Home Loan Bank	-	19,000	-
Repayments of short-term borrowings to Federal Home Loan Bank	(10,000)	(165,500)	(69,500)
Net increase in short-term borrowings	-	2,803	-
Repayment of borrowings from other financial institutions	(6,367)	-	(1,250)
Share repurchase and retirement	-	(56)	(2,707)
Proceeds from exercise of stock options	175	207	565
Tax benefit from exercise of stock options	7	57	395
Cash dividend payments on common stock	-	(598)	(595)
Cash dividend payments on preferred stock	(277)	-	-
Net cash provided by (used in) financing activities	13,405	30,421	(23,657)
Increase (decrease) in cash and cash equivalents	29,162	(12,126)	(16,472)
Cash and cash equivalents at beginning of year	19,518	31,644	48,116
Cash and cash equivalents at end of year	\$ 48,680	\$ 19,518	\$ 31,644

(Continued)

## CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY CONSOLIDATED STATEMENTS OF CASH FLOWS

(Continued)

For the Years Ended December 31, 2009, 2008 and 2007  
(In thousands)

	2009	2008	2007
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest	\$ 6,983	\$ 6,926	\$ 7,805
Income taxes	\$ 690	\$ 3,209	\$ 3,380
Non-cash investing activities:			
Net change in unrealized gain (loss) on available-for-sale investment securities	\$ (2,738)	\$ 79	\$ 429
Cumulative effect of adopting ASC 715-60 (previously EITF 06-04)	\$ -	\$ (316)	\$ -
Non-cash financing activities:			
Transfer of loans to other real estate owned	\$ 3,921	\$ -	\$ -
Accrued preferred stock dividends	\$ 44	\$ -	\$ -
Supplemental Schedule Related to Acquisitions:			
Acquisition of Service 1 <sup>st</sup> Bancorp:			
Deposits		\$ 193,488	
Fed funds purchased		3,565	
Short-term borrowings from Federal Home Loan Bank		10,000	
Junior subordinated deferrable interest debentures		5,155	
Other liabilities		4,220	
Loans, net		(116,028)	
Goodwill and intangibles		(16,239)	
Premises and equipment		(1,070)	
Federal Home Loan Bank stock		(1,000)	
Investment securities		(83,099)	
Other assets		(9,644)	
Bank owned life insurance		(3,816)	
Stock issued		<u>16,600</u>	
Cash and cash equivalents acquired, net of cash paid		<u>\$ 2,132</u>	

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

# Central Valley Community Bancorp and Subsidiary

## Notes To Consolidated Financial Statements

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### General

Central Valley Community Bancorp (the "Company") was incorporated on February 7, 2000 and subsequently obtained approval from the Board of Governors of the Federal Reserve System to be a bank holding company in connection with its acquisition of Central Valley Community Bank (the "Bank"). The Company became the sole shareholder of the Bank on November 15, 2000 in a statutory merger, pursuant to which each outstanding share of the Bank's common stock was exchanged for one share of common stock of the Company.

The Bank of Madera County (BMC) was merged with and into the Bank on January 1, 2005. The transaction was a combination of cash and stock and was accounted for under the purchase method of accounting. BMC had two branches in Madera County which continue to be operated by the Bank.

Service 1<sup>st</sup> Bancorp (Service 1<sup>st</sup>) and Service 1<sup>st</sup> Bank (S1 Bank) were merged with and into the Company and the Bank, respectively, on November 13, 2008. The transaction was a combination of cash and stock and was accounted for under the purchase method of accounting. Accordingly, the operating results of the Company only include the operations of Service 1<sup>st</sup> subsequent to the acquisition. Service 1<sup>st</sup> Bank had three branches in Tracy, Stockton and Lodi, California, which continue to be operated by the Bank.

Service 1<sup>st</sup> Capital Trust I (the "Trust") is a business trust formed by Service 1<sup>st</sup> for the sole purpose of issuing trust preferred securities. The Company succeeded to all the rights and obligations of Service 1<sup>st</sup> in connection with the acquisition of Service 1<sup>st</sup>. The Trust is a wholly-owned subsidiary of the Company.

The Bank operates 16 branches in Clovis, Fresno, west and northeast Fresno County, Madera County, Tracy, Stockton, Lodi, Merced and Sacramento, and a loan production office in Modesto, California. The Bank's primary source of revenue is providing loans to customers who are predominately small and middle-market businesses and individuals.

The deposits of the Bank are insured by the Federal Deposit Insurance Corporation (FDIC) up to applicable legal limits. The Bank is participating in the FDIC Transaction Account Guarantee Program. Under this program, through June 30, 2010, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account and the Bank is assessed an annual fee of 10 basis points for all deposit amounts exceeding the existing deposit insurance limit of \$250,000. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules.

The accounting and reporting policies of Central Valley Community Bancorp and Subsidiary conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Management has determined that because all of the banking products and services offered by the Company are available in each branch of the Bank, all branches are located within the same economic environment and management does not allocate resources based on the performance of different lending or transaction activities, it is appropriate to aggregate the Bank branches and report them as a single operating segment. No customer accounts for more than 10 percent of revenues for the Company or the Bank.

Certain reclassifications have been made to prior years' balances to conform to classifications used in 2009.

#### Principles of Consolidation

The consolidated financial statements include the accounts of the Company and the consolidated accounts of its wholly-owned subsidiary, the Bank.

For financial reporting purposes, Service 1<sup>st</sup> Capital Trust I, a wholly-owned subsidiary acquired in the merger of Service 1<sup>st</sup> Bancorp (see Note 2) and formed for the exclusive purpose of issuing trust preferred securities, is not consolidated into the Company's consolidated financial statements and, accordingly, is accounted for under the equity method. The Company's investment in the Trust is included in accrued interest receivable and other assets on the consolidated balance sheet. The junior subordinated deferrable interest debentures issued and guaranteed by the Company and held by the Trust are reflected as debt in the consolidated balance sheet.

#### Use of Estimates

The preparation of 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

#### Cash and Cash Equivalents

For the purpose of the statement of cash flows, cash, due from banks and Federal funds sold are considered to be cash equivalents. Generally, Federal funds are sold for one-day periods.

#### 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, adjusted for the accretion of discounts and amortization of premiums.

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. During 2009, one security was transferred from held-to-maturity to available-for-sale. As of December 31, 2008, there were no transfers between categories.

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.

Investment securities are impaired when the amortized cost exceeds fair value. Investment securities are evaluated for impairment 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. Once a decline in value is determined to be other-than-temporary and we do not intend to sell the security or it is more likely than not that we 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 we will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings. In 2009, the Company recognized a \$300,000 loss on one security that was other than temporarily impaired.

# Central Valley Community Bancorp and Subsidiary

## Notes To Consolidated Financial Statements (Continued)

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Loans

Loans are stated at principal balances outstanding. Interest is accrued daily based upon outstanding loan balances. However, when, in the opinion of management, loans are considered impaired and the future collectibility of interest and principal is in serious doubt, a loan is placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectibility of principal is not in doubt, are applied first to principal until fully collected and then to interest.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due (including both principal and interest) in accordance with the contractual terms of the loan agreement. Interest income on impaired loans, if appropriate, is recognized on a cash basis. An impaired loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical matter, at the loan's observable market price or the fair value of collateral if the loan is collateral dependent.

Substantially all loan origination fees, commitment fees, direct loan origination costs and purchase premiums and discounts on loans are deferred and recognized as an adjustment of yield, and amortized to interest income over the contractual term of the loan. The unamortized balance of deferred fees and costs is reported as a component of net loans.

The Company may acquire loans through a business combination or a purchase for which differences may exist between the contractual cash flows and the cash flows expected to be collected due, at least in part, to credit quality. When the Company acquires such loans, the yield that may be accreted (accretable yield) is limited to the excess of the Company's estimate of undiscounted cash flows expected to be collected over the Company's initial investment in the loan. The excess of contractual cash flows over cash flows expected to be collected may not be recognized as an adjustment to yield, loss, or a valuation allowance. Subsequent increases in cash flows expected to be collected generally are recognized prospectively through adjustment of the loan's yield over its remaining life. Decreases in cash flows expected to be collected are recognized as an impairment. The Company does not "carry over" or create a valuation allowance in the initial accounting for loans acquired under these circumstances.

At December 31, 2009, the Company has loans that were acquired through the merger with Service 1<sup>st</sup> for which there was, at acquisition, evidence of deterioration of credit quality since origination and for which it was probable, at acquisition, that all contractually required payments would not be collected.

Loans acquired for which it was probable at acquisition that all contractually required payments would not be collected are as follows (in thousands):

Contractually required payments at acquisition:	
Commercial	\$ 1,582
Real estate	10,650
Consumer	<u>149</u>
Outstanding balance at acquisition	<u>\$ 12,381</u>
Fair value at acquisition	<u>\$ 8,927</u>

Subsequent to the acquisition, all of these loans were placed on nonaccrual status. In 2009, the Bank foreclosed on one loan and the current carrying value is included in other real estate owned (OREO) at December 31, 2009. The outstanding contractual balance and carrying amount of loans and OREO at December 31, 2009 and 2008 are as follows (in thousands):

	<u>2009</u>	<u>2008</u>
Commercial	\$ 1,479	\$ 1,565
Real estate	5,185	10,765
Consumer	<u>147</u>	<u>149</u>
Outstanding balance	<u>\$ 6,811</u>	<u>\$ 12,479</u>
Carrying amount at December 31 included in loans	\$ 3,620	\$ 9,025
Carrying amount at December 31 included in OREO	<u>2,464</u>	<u>-</u>
Total at December 31	<u>\$ 6,084</u>	<u>\$ 9,025</u>

#### Allowance for Credit Losses

The allowance for credit losses is maintained to provide for losses related to impaired loans and other losses that can be expected to occur in the normal course of business. The determination of the allowance is based on estimates made by management, to include consideration of the character of the loan portfolio, specifically identified problem loans, potential losses inherent in the portfolio taken as a whole and economic conditions in the Bank's service area.

Classified loans and loans determined to be impaired are individually evaluated by management for specific risk of loss. In addition, a reserve factor is assigned to currently performing loans based on experience and other factors.

These estimates are susceptible to changes in the economic environment and market conditions.

The Bank's Audit Committee reviews the adequacy of the allowance for credit losses quarterly, to include consideration of the relative risks in the portfolio, current economic conditions and other factors. The allowance is adjusted based on that review if, in the judgment of the Audit Committee and management, changes are warranted.

This allowance is established through a provision for credit 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. The allowance for credit losses at December 31, 2009 and 2008, respectively, reflects management's estimate of probable losses inherent in the portfolio.

#### Bank Premises and Equipment

Bank premises and equipment are carried at cost. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful lives of Bank premises are estimated to be between twenty and forty years. The useful lives of improvements to Bank premises, 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 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.

The Bank evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.



# Central Valley Community Bancorp and Subsidiary

## Notes To Consolidated Financial Statements (Continued)

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Other Real Estate Owned

Other real estate owned (OREO) is comprised of property acquired through foreclosure proceedings or acceptance of deeds-in-lieu of foreclosure. Losses recognized at the time of acquiring property in full or partial satisfaction of debt are charged against the allowance for credit losses. OREO is initially recorded at fair value less estimated disposition costs. Fair value of OREO is generally based on an independent appraisal of the property. Subsequent to initial measurement, OREO is carried at the lower of the recorded investment or fair value less costs to sell. Revenues and expenses associated with OREO, and subsequent adjustment to the fair value of the property and to the estimated costs of disposal, are realized and reported as a component of noninterest expense when incurred.

At December 31, 2009 the Company had \$2,832,000 invested in two properties acquired through foreclosure. The properties are described in the following paragraph. These properties are carried at their fair value. Fair value is based on recently obtained third-party appraisals. The Company had no OREO properties at December 31, 2008.

The Company participated with an independent bank in a loan collateralized by an RV Park. On February 2, 2009, the Bank foreclosed on the loan and recorded the property as OREO at a net realizable value of \$2,550,000 based on a third-party appraisal. Subsequent to foreclosure, the Company recorded a valuation allowance of \$86,000 to reduce the value to an estimated realizable value of \$2,464,000 at December 31, 2009. In July 2009, the Company foreclosed on a construction loan for a commercial building and recorded the property at net realizable value of \$638,000 based on a third-party appraisal. Subsequent to foreclosure and based on an updated appraisal, the Company recorded an additional impairment charge of \$270,000 to reduce the estimated realizable value to \$368,000.

#### Goodwill

Business combinations involving the Bank's acquisition of the equity interests or net assets of another enterprise give rise to goodwill. Total goodwill at December 31, 2009 was \$23,577,000 consisting of \$14,643,000 and \$8,934,000 representing the excess of the cost of Service 1<sup>st</sup> Bank and Bank of Madera County, respectively, over the net of the amounts assigned to assets acquired and liabilities assumed in the transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Bank's ability to generate net earnings after the acquisitions 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 at least annually for impairment.

In conjunction with the Company's annual review during the first quarter of 2009, management engaged an independent valuation specialist to test goodwill for impairment. Goodwill impairment testing is a two step process. The first step compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount exceeds the fair value, the second step of the goodwill impairment test is performed to measure the impairment loss, if any. If the fair value of the reporting unit exceeds the carrying value, then goodwill is not impaired and step two is unnecessary. Since the Company is considered to be one reporting unit, the fair value of the Company was compared to the carrying value. Based on the results of the testing performed, the fair value of the Company exceeded the carrying value so step two was not required and goodwill was not impaired. The fair value of the Company was determined based on an analysis of three different valuation methods including the analysis of discounted future cash flows, comparable whole bank transactions, and the Company's market capitalization plus a control premium.

Goodwill is also tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the Company below its carrying amount. No such events or circumstances arose during the fourth quarter of 2009, so goodwill was not required to be retested.

#### Intangible Assets

The intangible assets represent the estimated fair value of the core deposit relationships acquired in the acquisition of Service 1<sup>st</sup> Bank in 2008 of \$1,400,000 and the 2005 acquisition of Bank of Madera County of \$1,500,000 at December 31, 2009. Core deposit intangibles are being amortized using the straight-line method over an estimated life of seven years from the date of acquisition. The carrying value of intangible assets at December 31, 2009 was \$1,612,000, net of \$1,288,000 in accumulated amortization expense. The carrying value at December 31, 2008 was \$2,009,000, net of \$891,000 accumulated amortization expense. Management evaluates the remaining useful lives quarterly to determine whether events or circumstances warrant a revision to the remaining periods of amortization. Based on the evaluation, no changes to the remaining useful lives was required. Management performed its annual impairment test on core deposit intangibles in the third quarter of 2009 and determined no impairment was necessary. Amortization expense recognized for 2009, 2008, and 2007 was \$414,000, \$231,000, and \$214,000, respectively.

#### Income Taxes

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

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. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. On the balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

#### Accounting for Uncertainty in Income Taxes

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.

#### Earnings Per Share

Basic earnings per share (EPS), which excludes dilution, is computed by dividing income available to common shareholders (net income after deducting dividends on preferred stock and accretion of discount) 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, result in the issuance of common stock which shares in the earnings of the Company. All data with respect to computing earnings per share is retroactively adjusted to reflect stock dividends and splits and the treasury stock method is applied to determine the dilutive effect of stock options in computing diluted EPS.

#### Share-Based Compensation

The Company has three share-based compensation plans, the Central Valley Community Bancorp 2005 Omnibus Incentive Plan and the 2000 and 1992 Stock Option Plans, all of which were approved by the shareholders of the Company. The Plans do not provide for the settlement of awards in cash and new shares are issued upon option exercise or restricted share grants. These plans are more fully described in Note 13.

In 2009, the Company granted options to purchase 13,500 shares of common stock. All options were granted with an exercise price equal to the fair market value on the grant date.

In December 2008, the Company cancelled options to purchase 90,550 shares of the Company's common stock granted on October 17, 2007 and options to purchase 15,000 shares of common stock granted on October 1, 2007, and on December 17, 2008 granted options to purchase 105,550 shares of common stock to the directors, senior managers and other employees. The modification affected 57 employees and eight directors and the total incremental compensation cost recognized for the modification in 2008 was \$38,000. In addition, the Company granted options to purchase 15,000 shares of common stock during 2008. All options were granted with an exercise price equal to the fair market value on the grant date.

# Central Valley Community Bancorp and Subsidiary

## Notes To Consolidated Financial Statements (Continued)

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Share-Based Compensation (Continued)

In October 2007, the Company cancelled options to purchase 15,000 shares of common stock granted on May 1, 2006 and 78,900 granted on April 23, 2007 and on October 17, 2007, granted options to purchase 93,900 shares of common stock to directors, senior managers and other employees. The modification affected 60 employees and eight directors and the total incremental compensation cost recognized for the modification in 2007 was \$29,000. In addition, the Company granted options to purchase 15,000 shares of common stock during 2007. All options were granted with an exercise price equal to the fair market value on the grant date.

The cash flows from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) are classified as a cash flows from financing activity in the statement of cash flows. Excess tax benefits for the years ended December 31, 2009, 2008 and 2007 were \$7,000, \$57,000 and \$395,000, respectively.

The Company bases the fair value of the options previously granted on the date of grant using a Black-Scholes-Merton option pricing model that uses assumptions based on expected option life, the level of estimated forfeitures, expected stock volatility and the risk-free interest rate. Stock volatility is based on the historical volatility of the Company's stock. The risk-free rate is based on the U.S. Treasury yield curve and the expected term of the options. The "simplified" method, described in the Securities and Exchange Commission (SEC) Staff Accounting Bulletin 110 is used to determine the expected term of its stock options due to the lack of sufficient historical data.

The fair value of each option is estimated on the date of grant using the following assumptions.

	2009	2008	2007
Dividend yield	0.10%	0.10%	0 - 0.10%
Expected volatility	31% - 38%	31%	28% - 29%
Risk-free interest rate	1.52% - 1.87%	2.29%	4.20% - 4.48%
Expected option term	6.5 years	6.5 years	6.5 years

#### Adoption of New Financial Accounting Standards

##### *FASB Accounting Standards Codification™ (ASC or Codification)*

In June 2009, the Financial Accounting Standards Board (FASB) issued new accounting standards ASC 105-10 (previously SFAS No. 168), *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles*. With the issuance of ASC 105-10, the FASB Accounting Standards Codification ("the Codification" or "ASC") becomes the single source of authoritative U.S. accounting and reporting standards applicable for all nongovernmental entities. Rules and interpretive releases of the SEC under the authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. This change is effective for financial statements issued for interim or annual periods ended after September 15, 2009. Accordingly, all specific references to generally accepted accounting principles (GAAP) refer to the Codification and not to the pre-Codification literature.

##### *Noncontrolling Interests in Consolidated Financial Statements*

In December 2007, the FASB issued ASC 810-10-65-1, (previously SFAS No. 160), *Noncontrolling Interests in Consolidated Financial Statements*. This standard requires that a noncontrolling interest in a subsidiary be reported separately within equity and the amount of consolidated net income specifically attributable to the noncontrolling interest be identified in the consolidated financial statements. It also calls for consistency in the manner of reporting changes in the parent's ownership interest and requires fair value measurement of any noncontrolling equity investment retained in a deconsolidation. This standard was effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company adopted the provisions of this standard on January 1, 2009 without a material impact on its financial condition or results of operations.

##### *FASB Clarifies Other-Than-Temporary Impairment*

In April 2009, the FASB issued ASC 320-10-35 (previously FSP 115-2 and 124-2 and EITF 99-20-2), *Recognition and Presentation of Other-Than-Temporary Impairment*. This standard (i) changes previously existing guidance for determining whether an impairment to debt securities is other than temporary and (ii) replaces the previously existing requirement that the entity's management assert it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. Under this standard, declines in fair value below cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses for both held-to-maturity and available-for-sale securities. The amount of impairment related to other factors is recognized in other comprehensive income. These changes were effective for interim and annual periods ended after June 15, 2009. The Company adopted the provisions of this standard on April 1, 2009. The Company recognized a \$300,000 loss in 2009 related to an other-than-temporary impairment of one debt security.

##### *FASB Clarifies Application of Fair Value Accounting*

In April 2009, the FASB issued ASC 820-10 (previously FSP FAS 157-4), *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*. This standard affirms the objective of fair value when a market is not active, clarifies and includes additional factors for determining whether there has been a significant decrease in market activity, eliminates the presumption that all transactions are distressed unless proven otherwise, and requires an entity to disclose a change in valuation technique. This standard was effective for interim and annual periods ended after June 15, 2009. The Company adopted the provisions of this standard on April 1, 2009 and they did not have a material impact on its financial condition or results of operations.

##### *Measuring Liabilities at Fair Value*

In August 2009, the FASB issued ASU No. 2009-05, *Fair Value Measurements and Disclosures (ASC Topic 820) — Measuring Liabilities at Fair Value*. This update provides amendments for the fair value measurement of liabilities. It provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more techniques. It also clarifies that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. This update was effective for the first reporting period (including interim periods) beginning after August 2009. The Company adopted the provisions of this update on October 1, 2009 and they did not have a material impact on its financial condition or results of operations.

##### *Business Combinations*

In December 2007, the FASB issued ASC Topic 805 (previously SFAS 141(R)), *Business Combinations*. This standard broadens the guidance for business combinations and extends its applicability to all transactions and other events in which one entity obtains control over one or more other businesses. It broadens the fair value measurement and recognition of assets acquired, liabilities assumed, and interests transferred as a result of business combinations. The acquirer is no longer permitted to recognize a separate valuation allowance as of the acquisition date for loans and other assets acquired in a business combination. It also requires acquisition-related costs and restructuring costs that the acquirer expected but was not obligated to incur to be expensed separately from the business combination. It also expands on required disclosures to improve the ability of the users of the financial statements to evaluate the nature and financial effects of business combinations. The Company will be required to apply this standard for future business combinations.

# Central Valley Community Bancorp and Subsidiary

## Notes To Consolidated Financial Statements (Continued)

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Adoption of New Financial Accounting Standards (Continued)

##### *Subsequent Events*

In February 2010, the FASB issued ASU 2010-2009 which amends ASC 855-10 (formerly SFAS No. 165), *Subsequent Events*, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The ASU addresses certain implementation issues related to an entity's requirement to perform and disclose subsequent-events procedures. The ASU requires SEC filers to evaluate subsequent events through the date the financial statements are issued and exempts SEC filers from disclosing the date through which subsequent events have been evaluated. The Company did not have any material recognizable or non recognizable subsequent events.

#### Impact of New Financial Accounting Standards

##### *Accounting for Transfers of Financial Assets*

In June 2009, the FASB issued ASC Topic 860 (previously SFAS No. 166), *Accounting for Transfers of Financial Assets, an amendment of SFAS No. 140*. This standard amends the derecognition accounting and disclosure guidance included in previously issued standards. This standard eliminates the exemption from consolidation for qualifying special-purpose entities (SPEs) and also requires a transferor to evaluate all existing qualifying SPEs to determine whether they must be consolidated in accordance with ASC Topic 810. This standard also provides more stringent requirements for derecognition of a portion of a financial asset and establishes new conditions for reporting the transfer of a portion of a financial asset as a sale. This standard is effective as of the beginning of the first annual reporting period that begins after November 15, 2009. The Company does not expect the adoption of this standard will have a material impact on its financial condition and results of operations.

##### *Transfers and Servicing*

In December 2009, the FASB issued Accounting Standards Update (ASU) 2009-16, *Transfers and Servicing (ASC Topic 860): Accounting for Transfers of Financial Assets*, which updates the derecognition guidance in ASC Topic 860 for previously issued SFAS No. 166. This update reflects the Board's response to issues entities have encountered when applying ASC 860, including: (1) requires that all arrangements made in connection with a transfer of financial assets be considered in the derecognition analysis, (2) clarifies when a transferred asset is considered legally isolated from the transferor, (3) modifies the requirements related to a transferee's ability to freely pledge or exchange transferred financial assets, and (4) provides guidance on when a portion of a financial asset can be derecognized. This update is effective for financial asset transfers occurring after the beginning of an entity's first fiscal year that begins after November 15, 2009. Early adoption is prohibited. The Company does not expect the adoption of this standard will have a material impact on its financial position or results of operations.

##### *Improvements to Financial Reporting of Interests in Variable Interest Entities*

In June 2009, the FASB issued ASC Topic 810 (previously SFAS No. 167), *Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*. This standard amends the consolidation guidance applicable to variable interest entities. The amendments to the consolidation guidance affect all entities currently within the scope of ASC Topic 810, as well as qualifying special-purpose entities that are currently excluded from the scope of ASC Topic 810. This standard is effective as of the beginning of the first annual reporting period that begins after November 15, 2009. The Company does not expect the adoption of this standard will have a material impact on its financial position or results of operations.

### 2. MERGER OF SERVICE 1<sup>ST</sup> BANCORP INTO CENTRAL VALLEY COMMUNITY BANCORP

After the close of business on November 12, 2008, the Company and Service 1<sup>st</sup> completed their previously announced merger and Service 1<sup>st</sup> was merged into the Company, and the Service 1<sup>st</sup> subsidiary, S1 Bank merged into the Bank. The Company acquired 100% of the outstanding common shares of Service 1<sup>st</sup> and the results of Service 1<sup>st</sup>'s operations have been included in the consolidated financial statements beginning November 13, 2008. Management believes that the merger will allow the Bank to further accommodate a growing customer base in San Joaquin County and provide Service 1<sup>st</sup> customers with more convenient locations in the Central Valley, as well as offer new advancement and geographic opportunities for their employees. As a result of the above factors, management believes that the potential for the combined performance exceeds what each entity could accomplish independently and the goodwill in this transaction arose from the synergies associated with the merger. The acquisition is part of the Company's long-term strategy to increase its presence from Sacramento to Bakersfield along the Highway 99 corridor and the surrounding foothills.

As of the date of acquisition, Service 1<sup>st</sup> had total assets at fair value of \$221,283,000, comprised of \$6,626,000 in cash and due from banks, \$83,099,000 in investment securities, \$116,028,000 in loans (net of allowance for credit losses of \$2,786,000), \$1,070,000 in premiums and equipment, \$3,816,000 in bank owned life insurance and \$10,644,000 in other assets. Total liabilities acquired at fair value amounted to \$216,428,000, including \$193,488,000 in deposits, \$13,565,000 in short-term borrowings, and \$5,155,000 in long-term borrowings.

The total consideration paid to Service 1<sup>st</sup> shareholders was approximately \$22,728,000. Under the merger agreement, Service 1<sup>st</sup> shareholders received in exchange for each share of Service 1<sup>st</sup> common stock held, cash in the amount of \$2.50 and shares of the Company's common stock based on an exchange ratio of 0.681818, representing an aggregate cash amount of \$5,972,000 and an aggregate share amount of 1,628,397 (valued at \$16,600,000 for purposes of the merger agreement) subject to a cash holdback of \$3,500,000, or approximately \$1.36 per share, that was deposited into an escrow account pending the outcome of certain litigation matters. Total consideration paid to Service 1<sup>st</sup> shareholders was established under the terms of the merger agreement based on a value of \$9.52 per share of Service 1<sup>st</sup> common stock. The Bank was party to a lawsuit filed related to a loan for the construction of a hotel, whereby the lead bank, Service 1<sup>st</sup> Bank and one other bank were participating in the loan. In 2009, the lead bank purchased the Bank's participating interest in the hotel loan at a discount and indemnified the Bank against any further actions pursuant to the lawsuit. Included in the merger consideration paid by the Company to acquire Service 1<sup>st</sup> was \$3,500,000 which was placed into an escrow fund to protect the Company and the Bank from all losses and liabilities that related to the loan participation and/or the litigation. Consequent to the lead bank buying the Bank's position, the Bank collected \$1,046,000 from the escrow fund to cover the portion of the loan that was not recovered, accrued and unpaid interest and other costs. In accordance with the escrow agreement, until the litigation is completely satisfied the remaining \$2,454,000 is expected to remain in the escrow fund.

The excess of the purchase price over the estimated fair value of the net assets acquired was \$14,839,000, which was recorded as goodwill, is not subject to amortization, and is not deductible for tax purposes. Goodwill decreased to \$14,643,000 in 2009. The reduction related to the reversal of the liability assumed at the time of the acquisition for split dollar benefit plans related to former Service 1<sup>st</sup> executives. The amount of the adjustment was \$196,000. In addition, assets acquired also included a core deposit intangible of \$1,400,000 which is being amortized using the straight-line method over a period of seven years with no significant residual value. Amortization expense recognized in 2009 and 2008 was \$217,000 and \$17,000, respectively.

The accompanying consolidated financial statements include the accounts of Service 1<sup>st</sup> since November 13, 2008. The following supplemental pro forma information discloses selected financial information for the periods indicated as though the Service 1<sup>st</sup> merger had been completed as of the beginning of each of the periods being reported. These results are not necessarily indicative of the results that could have been achieved had the companies operated on a combined basis nor does it include any synergies or cost savings that could have been implemented. Dollars are in thousands except per share data. 2008 pro forma net income includes non-recurring merger expenses for legal, accounting and other professional fees, net of tax, totaling \$595,000.

## Central Valley Community Bancorp and Subsidiary

### Notes To Consolidated Financial Statements (Continued)

#### 2. MERGER OF SERVICE 1<sup>ST</sup> BANCORP INTO CENTRAL VALLEY COMMUNITY BANCORP (Continued)

	Years Ended December 31,	
	2008	2007
Revenue	\$ 49,666	\$ 52,879
Net income	\$ 1,689	\$ 6,617
Diluted earnings per share	\$ 0.22	\$ 0.83

#### 3. FAIR VALUE MEASUREMENTS

The estimated carrying and fair values of the Company's financial instruments are as follows:

	December 31, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(In thousands)				
Financial assets:				
Cash and due from banks	\$ 13,857	\$ 13,857	\$ 18,061	\$ 18,061
Interest-earning deposits in other banks	34,544	34,544	-	-
Federal funds sold	279	279	1,457	1,457
Available-for-sale investment securities	197,319	197,319	185,718	185,718
Held-to-maturity investment securities	-	-	7,040	6,700
Loans, net	449,007	460,238	477,015	482,819
Bank owned life insurance	10,998	10,998	10,808	10,808
FHLB stock	3,140	3,140	3,140	3,140
Accrued interest receivable	3,608	3,608	3,710	3,710
Financial liabilities:				
Deposits	\$ 640,167	\$ 641,279	\$ 635,058	\$ 638,359
Short-term borrowings	5,000	5,000	6,368	6,368
Long-term debt	14,000	14,487	19,000	19,740
Junior subordinated defer- rable interest debentures	5,155	5,155	5,155	5,155
Accrued interest payable	416	416	718	718

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.

These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. Because no 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.

The following methods and assumptions were used to estimate the fair value of financial instruments. For cash and due from banks, interest-earning deposits in other banks, Federal funds sold, variable-rate loans, bank owned life insurance, accrued interest receivable and payable, FHLB stock, demand deposits and short-term borrowings, the carrying amount is estimated to be fair value. For investment securities, fair values are based on quoted market prices, quoted market prices for similar securities and indications of value provided by brokers. The fair values for fixed-rate loans are estimated using discounted cash flow analyses, using interest rates currently being offered at each reporting date for loans with similar terms to borrowers of comparable creditworthiness. Fair values for fixed-rate certificates of deposit are estimated using discounted cash flow analyses using interest rates offered at each reporting date by the Company for certificates with similar remaining maturities. The fair value of long-term debt and subordinated debentures was determined based on the current market for like-kind instruments of a similar maturity and structure. The fair values of commitments are estimated using the fees currently charged to enter into similar agreements and are not significant and, therefore, not included in the above table.

#### Fair Value Hierarchy

In accordance with applicable guidance, the Company groups its assets and liabilities measured at fair value into three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Valuations within these levels are based upon:

Level 1 – Quoted market prices for identical instruments traded in active exchange markets.

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

Level 3 – Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Company's estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

# Central Valley Community Bancorp and Subsidiary

## Notes To Consolidated Financial Statements (Continued)

### 3. FAIR VALUE MEASUREMENTS (Continued)

#### Assets Recorded at Fair Value

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, 2009:

#### Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis under other accounting pronouncements (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale investment securities	\$ 197,319	\$ 17	\$ 183,205	\$ 14,097

Fair values for available-for-sale investment securities, which include debt securities of U.S. Governmental agencies and obligations of states and political subdivisions, are based on quoted market prices for similar securities. The securities in Level 3 are not actively traded and therefore the pricing is internally calculated using matrix pricing.

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows for the year ended December 31, 2009 (in thousands).

	Available-for-Sale Investment Securities
Beginning balance	\$ 16,164
Total gains or losses (realized/unrealized)	
Included in earnings (or changes in net assets)	283
Included in other comprehensive income	809
Purchases, sales and principal payments	(884)
Transfers in and/or out of Level 3	(2,275)
Ending balance	\$ 14,097

Gains and losses (realized and unrealized) included in earnings (or changes in net assets) for the year ended December 31, 2009 totaled \$283,000 and were included in other revenues.

#### Non-recurring Basis

The Company may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. These include assets that are measured at the lower of cost or fair value that were recognized at fair value which was below cost at the reporting date (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3	Total Losses
Impaired loans	\$ 4,751	\$ -	\$ -	\$ 4,751	(3,253)
Other real estate owned	2,832	-	-	2,832	(356)
Other	47	-	-	47	(50)
Total assets and liabilities measured at fair value on a non-recurring basis	\$ 7,630	\$ -	\$ -	\$ 7,630	\$ (3,659)

The fair value of impaired loans and other real estate owned is based on the fair value of the collateral for all collateral dependent loans and for other impaired loans is estimated using a discounted cash flow model. Impaired loans and other real estate owned were determined to be collateral dependent and categorized as Level 3 due to ongoing real estate market conditions resulting in inactive market data, which in turn required the use of unobservable inputs and assumptions in fair value measurements.

In accordance with the provisions of ASC 360-10, impaired loans with a carrying value of \$9,112,000 were written down to their fair value of \$4,751,000, resulting in an impairment charge of \$3,253,000, which included \$2,501,000 in charge offs and specific reserve of \$752,000 for the period ended December 31, 2009. Other real estate properties with carrying amounts totaling \$3,189,000 at foreclosure were subsequently written down to their fair values of \$2,832,000, resulting in a loss of \$356,000 which was included in other expense for the period. Other repossessed assets with carrying amounts totaling \$97,000 were written down to their fair values of \$47,000, resulting in a loss of \$50,000 which was included in other expense for the period ended December 31, 2009.

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, 2008:

#### Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis under other accounting pronouncements (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale investment securities	\$ 185,718	\$ 3,297	\$ 166,257	\$ 16,164

Fair values for available-for-sale investment securities, which include debt securities of U.S. Governmental agencies and obligations of states and political subdivisions, are based on quoted market prices for similar securities. The securities in Level 3 are not actively traded and therefore the pricing is internally calculated using matrix pricing.

# Central Valley Community Bancorp and Subsidiary

## Notes To Consolidated Financial Statements (Continued)

### 3. FAIR VALUE MEASUREMENTS (Continued)

#### Assets Recorded at Fair Value (Continued)

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows for the year ended December 31, 2008 (in thousands).

	Available-for-Sale Investment Securities
Beginning balance	\$ 9,011
Total gains or losses (realized/unrealized)	
Included in earnings (or changes in net assets)	3
Included in other comprehensive income	457
Purchases, sales and principal payments	<u>6,693</u>
Ending balance	<u>\$ 16,164</u>

Gains and losses (realized and unrealized) included in earnings (or changes in net assets) for the year ended December 31, 2008 totaled \$3,000 and were included in other revenues.

#### Non-recurring Basis

The following table summarizes the balances of assets and liabilities measured at fair value on a nonrecurring basis at December 31, 2008 (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3	Total Losses
Impaired loans	\$ 15,750	\$ -	\$ 5,750	\$ -	\$ -

The fair value of impaired loans is based on the fair value of the collateral for all collateral dependent loans and for other impaired loans is estimated using a discounted cash flow model.

### 4. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities at December 31, 2009 and 2008 consisted of the following:

#### Available-for-Sale Securities

	2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In thousands)			
Debt securities:				
U.S. Government agencies	\$ 353	\$ 10	\$ -	\$ 363
Obligations of states and political subdivisions	68,708	3,050	(946)	70,812
U.S. Government agencies collateralized by mortgage obligations	85,530	1,283	(858)	85,955
Other collateralized mortgage obligations	36,280	403	(5,413)	31,270
Corporate debt securities	1,228	86	-	1,314
Other equity securities	<u>7,645</u>	<u>-</u>	<u>(40)</u>	<u>7,605</u>
	<u>\$ 199,744</u>	<u>\$ 4,832</u>	<u>\$ (7,257)</u>	<u>\$ 197,319</u>

#### Available-for-Sale Securities

	2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In thousands)			
Debt securities:				
U.S. Government agencies	\$ 12,745	\$ 116	\$ (1)	\$ 12,860
Obligations of states and political subdivisions	56,961	2,469	(808)	58,622
U.S. Government agencies collateralized by mortgage obligations	44,967	813	(23)	45,757
Other collateralized mortgage obligations	63,877	3,286	(6,274)	60,889
Corporate debt securities	2,686	28	(8)	2,706
Other equity securities	<u>4,169</u>	<u>755</u>	<u>(40)</u>	<u>4,884</u>
	<u>\$ 185,405</u>	<u>\$ 7,467</u>	<u>\$ (7,154)</u>	<u>\$ 185,718</u>

**Central Valley Community Bancorp and Subsidiary**  
Notes To Consolidated Financial Statements (Continued)

4. INVESTMENT SECURITIES (Continued)

Held-to-Maturity Securities	2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Other collateralized mortgage obligations	\$ 7,040	\$ -	\$ (340)	\$ 6,700

(In thousands)

Investment securities with unrealized losses at December 31, 2009 and 2008 are summarized and classified according to the duration of the loss period as follows:

	2009					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale Securities	(In thousands)					
Debt securities:						
Obligations of states and political sub-divisions	\$ 9,001	\$ (295)	\$ 4,911	\$ (651)	\$ 13,912	\$ (946)
U.S. Government agencies collateralized by mortgage obligations	40,691	(856)	331	(2)	41,022	(858)
Other collateralized mortgage obligations	3,474	(446)	19,878	(4,967)	23,352	(5,413)
Other equity securities	7,605	(40)	-	-	7,605	(40)
	<u>\$ 60,771</u>	<u>\$ (1,637)</u>	<u>\$ 25,120</u>	<u>\$ (5,620)</u>	<u>\$ 85,891</u>	<u>\$ (7,257)</u>

2008

	2008					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale Securities	(In thousands)					
Debt securities:						
U.S. Government agencies	\$ 2,277	\$ (1)	\$ -	\$ -	\$ 2,277	\$ (1)
Obligations of states and political sub-divisions	15,061	(808)	-	-	15,061	(808)
U.S. Government agencies collateralized by mortgage obligations	7,264	(17)	1,063	(6)	8,327	(23)
Other collateralized mortgage obligations	39,479	(6,153)	648	(121)	40,127	(6,274)
Corporate debt securities	50	(8)	-	-	50	(8)
Other securities	115	(12)	1,470	(28)	1,585	(40)
	<u>\$ 64,246</u>	<u>\$ (6,999)</u>	<u>\$ 3,181</u>	<u>\$ (155)</u>	<u>\$ 67,427</u>	<u>\$ (7,154)</u>

Held-to-Maturity Securities

Other collateralized mortgage obligations	\$ 6,700	\$ (340)	\$ -	\$ -	\$ 6,700	\$ (340)
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As of December 31, 2009, management performed an analysis of the investment portfolio to determine whether any of the investments held in the portfolio had an other-than-temporary impairment (OTTI). Management evaluated all available for sale investment securities with an unrealized loss at December 31, 2009 and identified those that had an unrealized loss for at least a consecutive 12 month period, which had an unrealized loss at December 31, 2009 greater than 10% of the recorded book value on that date, or which had an unrealized loss of more than \$10,000. In addition, management reviewed all private label residential mortgage backed securities (PLRMBS) at December 31, 2009.

For those bonds that met the evaluation criteria management obtained and reviewed the most recently published national credit ratings for those bonds. For those bonds that were municipal debt securities with an investment grade rating by the rating agencies, management also evaluated the financial condition of the municipality and any applicable municipal bond insurance provider and concluded that no credit related impairment existed based on the rating.

The Company's evaluation also includes estimating projected cash flows that the Company is likely to collect based on an assessment of all available information about the applicable security on an individual basis, the structure of the security, and certain assumptions, such as the remaining payment terms for the security, prepayment speeds, default rates, loss severity on the collateral supporting the security based on underlying loan-level borrower and loan characteristics, expected housing price changes, and interest rate assumptions, to determine whether the Company will recover the entire amortized cost basis of the security. In performing a detailed cash flow analysis, the Company identified the best estimate of the cash flows expected to be collected. If this estimate results in a present value of expected cash flows (discounted at the security's effective yield) that is less than the amortized cost basis of the security, an OTTI is considered to have occurred.

# Central Valley Community Bancorp and Subsidiary

## Notes To Consolidated Financial Statements (Continued)

### 4. INVESTMENT SECURITIES (Continued)

To assess whether it expects to recover the entire amortized cost basis of its PLRMBS, the Company performed a discounted cash flow analysis for all of its PLRMBS as of December 31, 2009. In performing the discounted cash flow analysis for each security, the Company uses a third-party model. The model considers borrower characteristics and the particular attributes of the loans underlying the Company's securities, in conjunction with assumptions about future changes in home prices and other assumptions, to project prepayments, default rates, and loss severities.

The month-by-month projections of future loan performance are allocated to the various security classes in each securitization structure in accordance with the structure's prescribed cash flow and loss allocation rules. When the credit enhancement for the senior securities in a securitization is derived from the presence of subordinated securities, losses are allocated first to the subordinated securities until their principal balance is reduced to zero. The projected cash flows are based on a number of assumptions and expectations, and the results of these models can vary significantly with changes in assumptions and expectations. The scenario of cash flows determined based on the model approach described above reflects a best-estimate scenario.

At each quarter end, the Company compares the present value of the cash flows expected to be collected on its PLRMBS to the amortized cost basis of the securities to determine whether a credit loss exists.

The unrealized losses associated with PLRMBS are primarily driven by higher projected collateral losses, wider credit spreads and changes in interest rates. The Company assesses for credit impairment using a discounted cash flow model. The key assumptions include home price depreciation, default rates, severities, discount rates and prepayment rates. Management estimates losses to a security by forecasting the underlying mortgage loans in each transaction. The forecasted loan performance is used to project cash flows to the various tranches in the structure. Based upon management's assessment of the expected credit losses of the security given the performance of the underlying collateral compared with our credit enhancement (which occurs as a result of credit loss protection provided by subordinated tranches), we expect to recover the entire amortized cost basis of these securities.

Based on the analyses performed, the expected discounted cash flows were greater than the recorded book value of the individual securities. Management recorded an OTTI loss of \$300,000 for one security that was sold at a loss subsequent to December 31, 2009, and recorded an unrealized loss in other comprehensive income for the other securities.

#### U.S. Government Agencies

At December 31, 2009, the Company held two U.S. Government agency securities of which none were in a loss position.

#### Obligations of States and Political Subdivisions

At December 31, 2009, the Company held 163 obligations of states and political subdivision securities of which 15 were in a loss position for less than 12 months and 13 were in a loss position and have been in a loss position for 12 months or more. The unrealized losses on the Company's investments in obligations of states and political subdivision securities were caused by interest rate changes. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell, and it is more likely than not that it will not be required to sell those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2009.

#### U.S. Government Agencies Collateralized by Mortgage Obligations

At December 31, 2009, the Company held 144 U.S. Government agency securities collateralized by mortgage obligation securities of which 17 were in a loss position for less than 12 months and two were in a loss position for 12 months or more. The unrealized losses on the Company's investments in U.S. government agencies collateralized by mortgage obligations were caused by interest rate changes. The contractual cash flows of those investments are guaranteed by an agency of the U.S. government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company's investment. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell, and it is more likely than not that it will not be required to sell those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2009.

#### Other Collateralized Mortgage Obligations

At December 31, 2009, the Company had a total of 46 PLRMBS holdings with a remaining principal balance of \$36,280,000 and a net unrealized loss of approximately \$5,010,000. 19 of these securities account for \$5,413,000 of the unrealized loss at December 31, 2009 offset by 27 of these securities with gains totaling \$403,000. 12 of these PLRMBS holdings with a remaining principal balance of \$24,230,000 had credit ratings below investment grade. The Company continues to perform extensive analyses on these securities as well as all whole loan CMOs. These investment securities continue to demonstrate cash flows and credit support as expected and the expected cash flows of the security discounted at the security's implicit interest rate are greater than the book value of the security, therefore management does not consider these to be other than temporarily impaired.

Investment securities as of December 31, 2009 with credit ratings below investment grade are summarized in the table below (dollars in thousands):

Description	Current Book Value	Market Value	Unrealized (Loss) or Gain	Rating	Agency	12 Month	Projected Default Rates %	Projected Severity Rates %	Original Purchase Price %	Current Credit Enhancement %
						Historical Prepayment Rates %				
PHHAM	\$ 3,777	\$ 3,078	\$ (699)	CC	Fitch	12.42	37.5	45.9	97.25	6.53
RAST	3,588	2,417	(1,171)	C	Fitch	9.95	25.5	44.5	98.5	3.67
CWALT No. 1	1,277	906	(371)	CC	Fitch	13.38	23.9	36.6	100.73	9.04
CWALT No. 2	559	462	(97)	CC	Fitch	13.36	29.7	35.9	101.38	8.64
CWALT No. 3	2,862	2,582	(280)	CCC	S&P	11.84	23.1	30.0	100.25	10.59
FHAMS	3,021	2,110	(911)	CC	Fitch	15.77	21.8	32.6	95.00	4.32
CHASE	376	361	(15)	CC	Fitch	17.39	21.2	33.7	93.25	5.21
BOAA	849	732	(117)	CCC	Fitch	9.05	13.6	28.5	95.00	6.20
GSR	3,355	2,786	(569)	CC	Fitch	13.48	24.0	35.5	96.25	4.72
CWHL	2,934	2,934	-	CCC	Fitch	19.26	19.2	29.2	92.00	4.39
BOAA	234	146	(88)	BB	Fitch	7.53	11.7	30.1	97.25	5.86
BAFC	1,398	1,529	131	CCC	S&P	10.07	25.8	38.9	63.50	5.65
<b>TOTALS</b>	<b>\$ 24,230</b>	<b>\$ 20,043</b>	<b>\$ (4,187)</b>							

All securities in the above table are private label residential collateralized mortgage obligations.



## Central Valley Community Bancorp and Subsidiary

### Notes To Consolidated Financial Statements (Continued)

#### 4. INVESTMENT SECURITIES (Continued)

##### Corporate Debt and Other Securities

At December 31, 2009, the Company's corporate debt and other securities consist of five investments in corporate debt securities and equity investments in a CRA qualified mutual fund that invests in government agency issued mortgaged backed securities and collateralized mortgage obligations. Two of the investments were in a loss position for less than 12 months. The unrealized losses on the Company's corporate debt and other securities were caused by interest rate changes and illiquidity in certain markets. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell, and it is more likely than not that it will not be required to sell those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2009.

Net unrealized (losses) gains on available-for-sale investment securities totaling \$(2,425,000) and \$313,000 are recorded net of \$970,000 and \$(125,000) in tax benefits (liabilities) as accumulated other comprehensive income within shareholders' equity at December 31, 2009 and 2008, respectively.

Proceeds and gross realized gains (losses) on investment securities at December 31, 2009, 2008 and 2007 are shown below.

Available-for-Sale Securities	Years Ended December 31,		
	2009	2008	2007
		(In thousands)	
Proceeds from sales or calls	\$ 40,407	\$ 12,327	\$ 15,700
Net realized gains from sales or calls	\$ 942	\$ 165	\$ 63
Held-to-Maturity	Years Ended December 31,		
	2009	2008	2007
		(In thousands)	
Proceeds from sales or calls	\$ 1,474	\$ -	\$ -
Net realized losses from sales or calls	\$ (176)	\$ -	\$ -

In 2009, one security was transferred from held-to-maturity to available-for-sale at its fair value based on management's intent to sell, and subsequent to the transfer, a \$300,000 charge to earnings was recorded as OTTI expense. There were no sales or transfers of held-to-maturity investment securities for the year ended December 31, 2008. The Company did not have any held-to-maturity securities at December 31, 2009.

The following table is a roll forward of the amount of other-than-temporary impairment related to credit losses that have been recognized in earnings for the year ended December 31, 2009 (in thousands):

Beginning balance of OTTI related to credit losses	\$ -
Credit portion of OTTI on securities for which OTTI was not previously recognized	300
Ending balance of OTTI related to credit losses	<u>\$ 300</u>

The amortized cost and estimated fair value of investment securities at December 31, 2009 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale	
	Amortized Cost	Estimated Fair Value
		(In thousands)
After one year through five years	\$ 1,522	\$ 1,571
After five years through ten years	18,573	19,365
After ten years	<u>50,194</u>	<u>51,553</u>
	70,289	72,489
Investment securities not due at a single maturity date:		
U.S. Government agencies collateralized by mortgage obligations	85,530	85,955
Other collateralized mortgage obligations	36,280	31,270
Other equity securities	<u>7,645</u>	<u>7,605</u>
	<u>\$ 199,744</u>	<u>\$ 197,319</u>

Investment securities with amortized costs totaling \$124,512,000 and \$111,851,000 and fair values totaling \$126,585,000 and \$111,922,000 were pledged to secure public deposits, other contractual obligations and short-term borrowings at December 31, 2009 and 2008, respectively.

## Central Valley Community Bancorp and Subsidiary

### Notes To Consolidated Financial Statements (Continued)

#### 5. LOANS AND ALLOWANCE FOR CREDIT LOSSES

Outstanding loans are summarized as follows:

	December 31,	
	2009	2008
	(In thousands)	
Commercial:		
Commercial and industrial	\$ 113,535	\$ 129,563
Agricultural land and production	35,796	32,408
Total commercial	149,331	161,971
Real estate:		
Owner occupied	106,606	113,414
Real estate – construction and other land loans	36,169	46,558
Commercial real estate	71,977	64,358
Other	48,187	49,425
Total real estate	262,939	273,755
Consumer:		
Equity lines of credit	36,110	32,874
Consumer and installment	10,545	14,993
Other	674	863
Total consumer	47,329	48,730
Deferred loan fees, net	(392)	(218)
Total gross loans	459,207	484,238
Allowance for credit losses	(10,200)	(7,223)
Total loans	<u>\$ 449,007</u>	<u>\$ 477,015</u>

At December 31, 2009 and 2008, loans originated under Small Business Administration (SBA) programs totaling \$29,698,000 and \$29,321,000, respectively, were included in the real estate and commercial categories.

Salaries and employee benefits totaling \$229,000, \$285,000 and \$326,000 have been deferred as loan origination costs for the years ended December 31, 2009, 2008 and 2007, respectively.

Changes in the allowance for credit losses were as follows:

	Years Ended December 31,		
	2009	2008	2007
	(In thousands)		
Balance, beginning of year	\$ 7,223	\$ 3,887	\$ 3,809
Provision charged to operations	10,514	1,290	480
Losses charged to the allowance	(7,926)	(851)	(481)
Recoveries	389	111	79
Allowance from merger with Service 1 <sup>st</sup>	-	2,786	-
Balance, end of year	<u>\$ 10,200</u>	<u>\$ 7,223</u>	<u>\$ 3,887</u>

At December 31, 2009 and 2008, the recorded investment in impaired loans was \$18,959,000 and \$15,750,000, respectively. The Company had \$752,000 and \$125,000 of specific allowance for loan losses on impaired loans at December 31, 2009 and 2008, respectively. The average outstanding balance of impaired loans for the years ended December 31, 2009, 2008 and 2007 was \$13,117,000, \$2,724,000 and \$113,000, respectively, and no income was recognized as interest income on a cash basis in any year.

Nonaccrual loans totaled \$18,959,000 and \$15,750,000 at December 31, 2009 and 2008, respectively. Foregone interest on nonaccrual loans totaled \$852,000, \$371,000, and \$8,000 for the years ended December 31, 2009, 2008 and 2007, respectively. There were no accruing loans past due 90 days or more at December 31, 2009 or 2008.

Included in the impaired and nonaccrual loans above are seven loans in the amount of \$4,568,000 that were considered to be troubled debt restructurings at December 31, 2009. There are no outstanding commitments to lend additional funds to any of these borrowers.

#### 6. BANK PREMISES AND EQUIPMENT

Bank premises and equipment consisted of the following:

	December 31,	
	2009	2008
	(In thousands)	
Land	\$ 580	\$ 580
Buildings and improvements	3,091	3,087
Furniture, fixtures and equipment	6,958	6,408
Leasehold improvements	3,571	3,236
	14,200	13,311
Less accumulated depreciation and amortization	(7,675)	(6,411)
	<u>\$ 6,525</u>	<u>\$ 6,900</u>

Depreciation and amortization included in occupancy and equipment expense totaled \$1,367,000, \$1,028,000 and \$935,000 for the years ended December 31, 2009, 2008 and 2007, respectively.

# Central Valley Community Bancorp and Subsidiary

## Notes To Consolidated Financial Statements (Continued)

### 7. DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31,	
	2009	2008
	(In thousands)	
Savings	\$ 24,446	\$ 21,232
Money market	142,917	128,239
NOW accounts	112,493	111,494
Time, \$100,000 or more	134,964	108,254
Time, under \$100,000	65,717	103,733
	<u>\$ 480,537</u>	<u>\$ 472,952</u>

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

Years Ending December 31,	
2010	\$ 177,592
2011	8,481
2012	8,028
2013	1,251
2014	5,327
Thereafter	<u>2</u>
	<u>\$ 200,681</u>

Interest expense recognized on interest-bearing deposits consisted of the following:

	Years Ended December 31,		
	2009	2008	2007
	(In thousands)		
Savings	\$ 49	\$ 65	\$ 98
Money market	1,262	2,098	2,621
NOW accounts	722	214	347
Time certificates of deposit	3,834	3,963	4,828
	<u>\$ 5,867</u>	<u>\$ 6,340</u>	<u>\$ 7,894</u>

### 8. BORROWING ARRANGEMENTS

#### Federal Home Loan Bank Advances

Advances from the Federal Home Loan Bank (FHLB) of San Francisco at December 31, 2009 and 2008 consisted of the following:

2009			2008		
Amount	Rate	Maturity Date	Amount	Rate	Maturity Date
(Dollars in thousands)			(Dollars in thousands)		
\$ 5,000	2.73%	February 5, 2010	\$ 5,000	2.73%	February 5, 2010
5,000	3.00%	February 7, 2011	5,000	3.00%	February 7, 2011
5,000	3.10%	February 14, 2011	5,000	3.10%	February 14, 2011
<u>4,000</u>	3.59%	February 12, 2013	<u>4,000</u>	3.59%	February 12, 2013
19,000			19,000		
<u>(5,000)</u>	Less short-term portion		-	Less short-term portion	
<u>\$ 14,000</u>	Long-term debt		<u>\$ 19,000</u>	Long-term debt	

FHLB advances are secured by investment securities with amortized costs totaling \$45,239,000 and \$54,350,000 and market values totaling \$44,808,000 and \$52,783,000 at December 31, 2009 and 2008, respectively. The Bank's credit limit varies according to the amount and composition of the investment and loan portfolios pledged as collateral.

#### Lines of Credit

The Bank had unsecured lines of credit with its correspondent banks which, in the aggregate, amounted to \$39,000,000 at December 31, 2009 and 2008, at interest rates which vary with market conditions. The Bank also had a line of credit in the amount of \$917,000 and \$1,878,000 with the Federal Reserve Bank of San Francisco at December 31, 2009 and 2008, respectively which bears interest at the prevailing discount rate collateralized by investment securities with amortized costs totaling \$922,000 and \$1,885,000 and market values totaling \$956,000 and \$1,929,000, respectively. At December 31, 2009, the Bank had no outstanding short-term borrowings under these lines of credit. At December 31, 2008, the Bank had \$6,368,000 in outstanding short-term borrowings under these lines of credit.

## Central Valley Community Bancorp and Subsidiary

### Notes To Consolidated Financial Statements (Continued)

#### 9. JUNIOR SUBORDINATED DEFERRABLE INTEREST DEBENTURES

Service 1<sup>st</sup> Capital Trust I is a Delaware business trust formed by Service 1<sup>st</sup>. The Company succeeded to all of the rights and obligations of Service 1<sup>st</sup> in connection with the merger with Service 1<sup>st</sup> as of November 12, 2008. The Trust was formed on August 17, 2006 for the sole purpose of issuing trust preferred securities fully and unconditionally guaranteed by Service 1<sup>st</sup>. Under applicable regulatory guidance, the amount of trust preferred securities that is eligible as Tier 1 capital is limited to 25% of the Company's Tier 1 capital on a pro forma basis. At December 31, 2009, all of the trust preferred securities that have been issued qualify as Tier 1 capital. The trust preferred securities mature on October 7, 2036, are redeemable at the Company's option beginning after five years, and require quarterly distributions by the Trust to the holder of the trust preferred securities at a variable interest rate which will adjust quarterly to equal the three month LIBOR plus 1.60%.

The Trust used the proceeds from the sale of the trust preferred securities to purchase approximately \$5,155,000 in aggregate principal amount of Service 1<sup>st</sup>'s junior subordinated notes (the Notes). The Notes bear interest at the same variable interest rate during the same quarterly periods as the trust preferred securities. The Notes are redeemable by the Company on any January 7, April 7, July 7, or October 7 on or after October 7, 2011 or at any time within 90 days following the occurrence of certain events, such as: (i) a change in the regulatory capital treatment of the Notes (ii) in the event the Trust is deemed an investment company or (iii) upon the occurrence of certain adverse tax events. In each such case, the Company may redeem the Notes for their aggregate principal amount, plus any accrued but unpaid interest.

The Notes may be declared immediately due and payable at the election of the trustee or holders of 25% of the aggregate principal amount of outstanding Notes in the event that the Company defaults in the payment of any interest following the nonpayment of any such interest for 20 or more consecutive quarterly periods.

Holders of the trust preferred securities are entitled to a cumulative cash distribution on the liquidation amount of \$1,000 per security. For each January 7, April 7, July 7 or October 7 of each year, the rate will be adjusted to equal the three month LIBOR plus 1.60%. As of December 31, 2009, the rate was 1.88%. Interest expense recognized by the Company for the year ended December 31, 2009 was \$129,000.

#### 10. INCOME TAXES

The provision (benefit) for income taxes for the years ended December 31, 2009, 2008 and 2007 consisted of the following:

	<u>Federal</u>	<u>State</u>	<u>Total</u>
		(In thousands)	
<u>2009</u>			
Current	\$ (1,374)	\$ (90)	\$ (1,464)
Deferred	<u>804</u>	<u>(16)</u>	<u>788</u>
Provision (Benefit) for income taxes	<u>\$ (570)</u>	<u>\$ (106)</u>	<u>\$ (676)</u>
<u>2008</u>			
Current	\$ 1,851	\$ 556	\$ 2,407
Deferred	<u>108</u>	<u>(163)</u>	<u>(55)</u>
Provision for income taxes	<u>\$ 1,959</u>	<u>\$ 393</u>	<u>\$ 2,352</u>
<u>2007</u>			
Current	\$ 2,982	\$ 588	\$ 3,570
Deferred	<u>(265)</u>	<u>(138)</u>	<u>(403)</u>
Provision for income taxes	<u>\$ 2,717</u>	<u>\$ 450</u>	<u>\$ 3,167</u>

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. 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 asset will not be realized. More likely than not is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of the evidence, a valuation allowance is needed. Based upon our analysis of available evidence, we have determined that it is more likely than not that all of our deferred income tax assets as of December 31, 2009 and 2008 will be fully realized and therefore no valuation allowance was recorded.

# Central Valley Community Bancorp and Subsidiary

## Notes To Consolidated Financial Statements (Continued)

### 10. INCOME TAXES (Continued)

Deferred tax assets (liabilities) consisted of the following:

	December 31,	
	2009	2008
	(In thousands)	
Deferred tax assets:		
State Enterprise Zone credit carry-forward	\$ 149	\$ -
State capital loss carry-forward	100	-
Alternative minimum tax credit	51	-
Other real estate	197	-
Allowance for credit losses	3,913	3,456
Other reserves	-	103
Bank premises and equipment	681	447
Deferred compensation	2,975	3,206
Other	147	-
State taxes	1	203
Other than temporary impairment	124	578
Mark to market adjustment	674	2,364
Loan and investment impairment	311	756
Net operating loss carryover from acquisition	2,706	1,978
Unrealized loss on available-for-sale investment securities	970	-
Total deferred tax assets	<u>12,999</u>	<u>13,091</u>
Deferred tax liabilities:		
Other deferred taxes	(23)	(639)
FHLB stock	(262)	(267)
Loan origination costs	(192)	(56)
Finance leases	(2,372)	(1,942)
Unrealized gain on available-for-sale investment securities	-	(125)
State tax refunds	(59)	(95)
Partnership income	(2)	(14)
Core deposit intangible	(663)	(834)
Total deferred tax liabilities	<u>(3,573)</u>	<u>(3,972)</u>
Net deferred tax assets	<u>\$ 9,426</u>	<u>\$ 9,119</u>

The provision for income taxes differs from amounts computed by applying the statutory Federal income tax rates to operating income before income taxes. The significant items comprising these differences for the years ended December 31, 2009, 2008 and 2007 consisted of the following:

	2009	2008	2007
Federal income tax, at statutory rate	34.0 %	34.0 %	34.0 %
State taxes, net of Federal tax benefit	(3.7) %	3.4 %	3.1 %
Tax exempt investment security income, net	(52.4)%	(4.7)%	(2.9)%
Bank owned life insurance, net	(6.9)%	(1.4)%	(0.8)%
Solar Credits	(15.7)%	-	-
Change in uncertain tax positions	7.7%	-	-
Other	1.7%	0.1 %	0.1 %
Effective tax rate	<u>(35.3)%</u>	<u>31.4 %</u>	<u>33.5 %</u>

At December 31, 2009, the Company had Federal and California net operating loss (NOLs) carry-forward of approximately \$5,643,000 and \$5,418,000, respectively from the Service 1<sup>st</sup> acquisition, subject to an Internal Revenue Code (IRC) Sec. 382 annual limitation of \$1,133,000. Management expects to fully utilize the Service 1<sup>st</sup> Federal and California NOL carry-forward. Federal NOL will begin to expire in 2028. California suspended utilization of NOLs for 2008 and 2009 tax years for taxpayers with business income in excess of \$500,000. The California NOL will begin to expire in 2019.

The Company and its Subsidiary file income tax returns in the U.S. federal and California jurisdictions. The Company conducts all of its business activities in the State of California. As of December 31, 2009, the Company had one state income tax examination in process. The outcome of the examination is not settled. There are currently no pending U.S. federal or local income tax examinations by those taxing authorities. With the exception related to claims for refunds for tax years 2002 through 2004, the Company is no longer subject to the examination by U.S. federal taxing authorities for the years ended before December 31, 2006 and by the state and local taxing authorities for the years ended before December 31, 2005.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

Balance at January 1, 2009	\$ 162
Additions based on tax positions related to the current year	49
Additions for tax positions of prior years	133
Reductions for tax positions of prior years	<u>(34)</u>
Balance at December 31, 2009	<u>\$ 310</u>

In 2009, the Company recognized \$32,000 of interest related to the pending state tax examination and no penalties related to uncertain tax positions. During the year ended December 31, 2008, the Company did not recognize any interest and penalties related to uncertain tax positions.

# Central Valley Community Bancorp and Subsidiary

## Notes To Consolidated Financial Statements (Continued)

### 11. COMMITMENTS AND CONTINGENCIES

#### Leases

The Bank leases certain of its branch facilities and administrative offices under noncancelable operating leases. Rental expense included in occupancy and equipment and other expenses totaled \$1,796,000, \$1,244,000 and \$1,047,000 for the years ended December 31, 2009, 2008 and 2007, respectively.

Future minimum lease payments on noncancelable operating leases are as follows (in thousands):

<u>Years Ending December 31,</u>		
2010	\$	1,772
2011		1,750
2012		1,583
2013		1,479
2014		1,471
Thereafter		<u>6,162</u>
	<u>\$</u>	<u>14,217</u>

#### Federal Reserve Requirements

Banks are required to maintain reserves with the Federal Reserve Bank equal to a percentage of their reservable deposits. The amount of such reserve balances required at December 31, 2009 and 2008 was \$25,000.

#### Correspondent Banking Agreements

The Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Uninsured deposits totaled \$254,000 at December 31, 2009.

#### Financial Instruments With Off-Balance-Sheet Risk

The Bank 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 own 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 balance sheet.

The Bank'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 Bank uses the same credit policies in making commitments and standby letters of credit as it does for loans included on the balance sheet.

The following financial instruments represent off-balance-sheet credit risk:

	<u>December 31,</u>	
	<u>2009</u>	<u>2008</u>
	(In thousands)	
Commitments to extend credit	\$ 130,899	\$ 158,896
Standby letters of credit	\$ 240	\$ 1,554

Commitments to extend credit consist primarily of unfunded commercial loan commitments and revolving lines of credit, single-family residential equity lines of credit and commercial real estate construction loans. Construction loans are established under standard underwriting guidelines and policies and are secured by deeds of trust, with disbursements made over the course of construction. Commercial revolving lines of credit have a high degree of industry diversification. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are generally secured and are issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to customers. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2009 and 2008. The Company recognizes these fees as revenue over the term of the commitment or when the commitment is used.

At December 31, 2009, commercial loan commitments represent approximately 57% of total commitments and are generally secured by collateral other than real estate or unsecured. Real estate loan commitments represent 29% of total commitments and are generally secured by property with a loan-to-value ratio not to exceed 80%. Consumer loan commitments represent the remaining 14% of total commitments and are generally unsecured. In addition, the majority of the Bank's loan commitments have variable interest rates.

#### Concentrations of Credit Risk

At December 31, 2009, in management's judgment, a concentration of loans existed in commercial loans and real-estate-related loans, representing approximately 97.6% of total loans of which 32.5% were commercial and 65.1% were real-estate-related.

At December 31, 2008, in management's judgment, a concentration of loans existed in commercial loans and real-estate-related loans, representing approximately 96.8% of total loans of which 33.5% were commercial and 63.3% were real-estate-related.

Management believes the loans within these concentrations have no more than the typical risks of collectibility. However, in light of the current economic environment, additional declines in the performance of the economy in general or a continued decline in real estate values in the Company's primary market area, in particular, could have an adverse impact on collectibility, increase the level of real-estate-related nonperforming loans, or have other adverse effects which alone or in the aggregate could have a material adverse effect on the financial condition, results of operations and cash flows of the Company.

#### 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 consolidated results of operations of the Company.

# Central Valley Community Bancorp and Subsidiary

## Notes To Consolidated Financial Statements (Continued)

### 12. SHAREHOLDERS' EQUITY

#### Regulatory Capital

The Company and the Bank 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, the Company and the Bank 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. These quantitative measures are established by regulation and require that minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets be maintained. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

The Bank is also subject to additional capital guidelines under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table on the following page. The most recent notification from the FDIC categorized the Bank as well capitalized under these guidelines. There are no conditions or events since that notification that management believes have changed the Bank's category.

Management believes that the Company and the Bank met all their capital adequacy requirements as of December 31, 2009 and 2008. There are no conditions or events since those notifications that management believes have changed those categories.

	2009		2008	
	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)			
<u>Tier 1 Leverage Ratio</u>				
Central Valley Community Bancorp and Subsidiary	\$ 67,547	9.30%	\$ 54,519	8.67%
Minimum regulatory requirement	\$ 29,056	4.00%	\$ 25,148	4.00%
Central Valley Community Bank	\$ 66,624	9.20%	\$ 51,296	8.18%
Minimum requirement for "Well-Capitalized" institution	\$ 36,210	5.00%	\$ 31,360	5.00%
Minimum regulatory requirement	\$ 28,968	4.00%	\$ 25,088	4.00%
<u>Tier 1 Risk-Based Capital Ratio</u>				
Central Valley Community Bancorp and Subsidiary	\$ 67,547	12.28%	\$ 54,519	9.33%
Minimum regulatory requirement	\$ 21,998	4.00%	\$ 23,374	4.00%
Central Valley Community Bank	\$ 66,624	12.12%	\$ 51,296	8.81%
Minimum requirement for "Well-Capitalized" institution	\$ 32,977	6.00%	\$ 34,934	6.00%
Minimum regulatory requirement	\$ 21,985	4.00%	\$ 23,289	4.00%
<u>Total Risk-Based Capital Ratio</u>				
Central Valley Community Bancorp and Subsidiary	\$ 74,463	13.54%	\$ 61,742	10.57%
Minimum regulatory requirement	\$ 43,996	8.00%	\$ 46,748	8.00%
Central Valley Community Bank	\$ 73,535	13.38%	\$ 58,519	10.05%
Minimum requirement for "Well-Capitalized" institution	\$ 54,962	10.00%	\$ 58,223	10.00%
Minimum regulatory requirement	\$ 43,970	8.00%	\$ 46,579	8.00%

#### Dividends

On February 20, 2008, the Board of Directors declared a \$0.10 per share cash dividend for shareholders of record as of March 11, 2008, payable on March 31, 2008. On July 19, 2007, the Board of Directors declared a \$0.10 per share cash dividend for shareholders of record as of August 8, 2007, payable on August 24, 2007.

The Company's primary source of income with which to pay cash dividends is dividends from the Bank. The California Financial Code restricts the total amount of dividends payable by a bank at any time without obtaining the prior approval of the California Department of Financial Institutions 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. At December 31, 2009, retained earnings of \$5,121,000 were free of such restrictions. Dividends on common stock in 2010 will also be limited without the prior approval of the United States Treasury due to the Company's participation in the Capital Purchase Program.

#### Share Repurchase Plan

No shares were repurchased under a repurchase plan during 2009 or 2008. In 2008, the Company repurchased 5,436 shares of common stock from shareholders who perfected their dissenters' rights related to the acquisition of Service 1<sup>st</sup> at an average price of \$10.30 for a total cost of \$56,000. During 2007, the Company repurchased 186,800 shares of common stock at an average price of \$14.49 for a total cost of \$2,707,000.

#### Stock Purchase Agreements

On December 23, 2009, the Company entered into Stock Purchase Agreements (Agreements) with a limited number of accredited investors (collectively, the "Purchasers") to sell to the Purchasers a total of 1,264,952 shares of common stock, (Common Stock) at \$5.25 per share and 1,359 shares of non-voting Series B Convertible Adjustable Rate Non-Cumulative Perpetual Preferred Stock (Series B Preferred Stock) at \$1,000 per share, for an aggregate gross purchase price of \$8,000,000 (the "Offering") offset by issuance costs totaling \$242,000. The Offering closed on December 23, 2009, and the Company issued an aggregate of 1,264,952 shares of its Common Stock and an aggregate of 1,359 shares of its Preferred Stock upon its receipt of consideration in cash.

Preferred Stock is eligible to receive a semi-annual non-cumulative preferred dividend with an initial annualized coupon of 10%, payable at the end of the first six months the shares are outstanding. The annual dividend rate will increase to 15% for the second six month period and 20% for each six month period thereafter. Dividends may not be paid on any other class or series of the Company's stock unless dividends are currently paid on the Preferred Stock in any period. In the event the shareholders of the Company approve an amendment to the Company's governing instruments to create a series of non-voting common stock, the Company shall have the option to require the Purchasers to exchange the Preferred Stock for such non-voting common stock.

Pursuant to the Agreements, the Company has agreed to file a registration statement with the Securities and Exchange Commission to register for resale the shares of Common Stock issued to the Purchasers in the Offering within six months after the closing of the Offering.

# Central Valley Community Bancorp and Subsidiary

## Notes To Consolidated Financial Statements (Continued)

### 12. SHAREHOLDERS' EQUITY (Continued)

#### Capital Purchase Program – Troubled Asset Relief Program

On January 30, 2009, the Company entered into a Letter Agreement (the Purchase Agreement) with the United States Department of the Treasury (the Treasury), pursuant to which the Company issued and sold (i) 7,000 shares of the Company's Series A Fixed Rate Cumulative Perpetual Preferred Stock (the Series A Preferred Stock) and (ii) a warrant (the Warrant) to purchase 158,133 shares of the Company's common stock, no par value, (the Common Stock) for an aggregate purchase price of \$7,000,000 in cash.

The Series A Preferred Stock will qualify as Tier 1 capital and will pay cumulative dividends quarterly at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The Series A Preferred Stock may be redeemed by the Company after three years. Prior to the end of three years, the Series A Preferred Stock may be redeemed by the Company only with proceeds from the sale of qualifying equity securities of the Company (a Qualified Equity Offering). Preferred stock dividends paid in 2009 totaled \$277,000.

The Warrant has a 10-year term and is immediately exercisable upon its issuance, with an exercise price, subject to anti-dilution adjustments, equal to \$6.64 per share of the Common Stock.

According to the agreement, if the Company receives aggregate gross cash proceeds of not less than \$7,000,000 from Qualified Equity Offerings on or prior to December 31, 2009, the number of shares of Common Stock issuable pursuant to the Treasury's exercise of the Warrant will be reduced by one half of the original number of shares (the contingently exercisable portion), taking into account all adjustments, underlying the Warrant. On December 23, 2009, the Company received \$8,000,000, as a result of entering into Stock Purchase Agreements to sell a total of 1,264,952 shares of common stock, without par value at \$5.25 per share and 1,359 shares of non-voting Series B Convertible Adjustable Rate Non-Cumulative Perpetual Preferred Stock at \$1,000 per share, for an aggregate gross purchase price of \$8,000,000. The Company submitted a request to the Treasury to cancel one half of the outstanding Warrants and received confirmation from the Treasury that the number of warrants was reduced to 79,067. Pursuant to the Purchase Agreement, the Treasury has agreed not to exercise voting power with respect to any shares of Common Stock issued upon exercise of the Warrant.

The Series A Preferred Stock and the Warrant were issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. Upon the request of the Treasury at any time, the Company has agreed to promptly enter into a deposit arrangement pursuant to which the Preferred Stock may be deposited and depository shares (the Depository Shares) representing fractional shares of the Preferred Stock, may be issued. The Company has agreed to register the Series A Preferred Stock, the Warrant, the shares of Common Stock underlying the Warrant (the Warrant Shares), and Depository Shares, as soon as practicable after the date of the issuance of the Series A Preferred Stock and the Warrant in accordance with the terms of the Purchase Agreement. Neither the Series A Preferred Stock nor the Warrant will be subject to any contractual restrictions on transfer, except that the Treasury may only transfer or exercise an aggregate of one-half of the Warrant Shares prior to the earlier of the redemption of 100% of the shares of Series A Preferred Stock or December 31, 2009.

The Series A Preferred Stock shall be non-voting, other than class voting rights on (i) any authorization or issuance of shares ranking senior to the Series A Preferred Stock, (ii) any amendment to the rights of the Series A Preferred Stock, or (iii) any merger, exchange or similar transaction which would adversely affect the rights of the Series A Preferred Stock.

If dividends on the Series A Preferred Stock are not paid in full for six dividend periods, whether or not consecutive, the holders of the Series A Preferred Stock will have the right to elect 2 directors. The right to elect directors will end when full dividends have been paid for four consecutive dividend periods.

In the Purchase Agreement, the Company agreed that, until such time as the Treasury ceases to own any debt or equity securities of the Company acquired pursuant to the Purchase Agreement, the Company will take all necessary action to ensure that its benefit plans with respect to its senior executive officers comply with Section 111(b) of the Emergency Economic Stabilization Act of 2008 (the EESA) as implemented by any guidance or regulation under the EESA that has been issued and is in effect as of the date of issuance of the Series A Preferred Stock and the Warrant, and has agreed to not adopt any benefit plans with respect to, or which cover, its senior executive officers that do not comply with the EESA, and the applicable executives have consented to the foregoing. Furthermore, the Purchase Agreement allows the Treasury to unilaterally amend the terms of the agreement.

With respect to dividends on the Company's common stock, the Treasury's consent shall be required for any increase in common dividends per share until the third anniversary of the date of its investment unless prior to such third anniversary the Series A Preferred Stock is redeemed in whole or the Treasury has transferred all of the Series A Preferred Stock to third parties. Furthermore, for as long as any Series A Preferred Stock is outstanding, no dividends may be declared or paid on junior preferred shares, preferred shares ranking pari passu with the Series A Preferred Stock, or common shares (other than in the case of pari passu preferred shares, dividends on a pro rata basis with the Series A Preferred Stock), nor may the Company repurchase or redeem any junior preferred shares, preferred shares ranking pari passu with the Series A Preferred Stock or common shares, unless all accrued and unpaid dividends for all past dividend periods on the Series A Preferred Stock are fully paid.

The Company allocated the proceeds received from the U.S. Treasury between the Series A Preferred Stock and the Warrant issued based on the estimated relative fair values of each. The fair value of the Series A Preferred Stock was determined using a net present value calculation for preferred stock. The fair value of the Warrant was estimated based on a Black-Scholes-Merton model. The recorded investment in Series A Preferred Stock was \$6,775,000 and the fair value allocated to the Warrant was \$225,000. The discount recorded on the Series A Preferred Stock was equal to the fair value of the imbedded Warrant and is amortized using the level-yield method over five years.

The following table identifies the amount of the proceeds allocated to the Series A Preferred Stock and the Warrant based on their relative fair values.

	Series A Preferred Stock	Warrant	Total Fair Value
Fair value per share	\$ 820.86	\$ 1.21	
Number of shares	7,000	158,133	
Fair value	\$ 5,746,000	\$ 191,000	\$ 5,937,000
Percent of total fair value	96.78%	3.22%	
Allocation of \$7,000,000 proceeds based on percent of total fair value	<u>\$ 6,775,000</u>	<u>\$ 225,000</u>	<u>\$ 7,000,000</u>

The Company calculated the fair value of the Series A Preferred Stock using a net present value calculation for preferred stock with a five year call option, with an annual dividend rate of 5.0% and a 10.0% discount rate. Management determined the discount rate of 10.0% was appropriate based on the Company's risk profile using a Capital Asset Pricing model (CAPM).

The Company based the fair value of the Warrant granted using a Black-Scholes-Merton pricing model that uses assumptions based on estimated expected life, expected stock volatility and a discount rate based on the risk-free interest rate. Stock volatility is based on the historical volatility of the Company's stock. The risk-free rate is based on the U.S. Treasury yield curve for the periods within the contractual life of the Warrant in effect at the time of grant. The fair value of the Warrant was estimated on the date of grant using: i) dividend yield of 0.10%; ii) expected volatility of 32.13%; iii) 1.52% risk-free interest rate; iv) expected term of six and one half years; and v) expected vesting of the contingently exercisable portion of the Warrant of 85%.



## Central Valley Community Bancorp and Subsidiary

### Notes To Consolidated Financial Statements (Continued)

#### 12. SHAREHOLDERS' EQUITY (Continued)

##### Earnings Per Share

A reconciliation of the numerators and denominators of the basic and diluted earnings per share computations is as follows:

	For the Years Ended December 31,		
	2009	2008	2007
	(In thousands, except share and per share amounts)		
<b>Basic Earnings Per Share:</b>			
Net income	\$ 2,588	\$ 5,139	\$ 6,280
Less: Preferred stock dividends and accretion	(365)	-	-
Income available to common shareholders	<u>\$ 2,223</u>	<u>\$ 5,139</u>	<u>\$ 6,280</u>
Weighted average shares outstanding	<u>7,685,789</u>	<u>6,212,199</u>	<u>5,990,812</u>
Net income per share	<u>\$ 0.29</u>	<u>\$ 0.83</u>	<u>\$ 1.05</u>
<b>Diluted Earnings Per Share:</b>			
Net income	\$ 2,588	\$ 5,139	\$ 6,280
Less: Preferred stock dividends and accretion	(365)	-	-
Income available to common shareholders	<u>\$ 2,223</u>	<u>\$ 5,139</u>	<u>\$ 6,280</u>
Weighted average shares outstanding	7,685,789	6,212,199	5,990,812
Effect of dilutive stock options	<u>117,975</u>	<u>257,037</u>	<u>376,438</u>
Weighted average shares of common stock and common stock equivalents	<u>7,803,764</u>	<u>6,469,236</u>	<u>6,367,250</u>
Net income per diluted share	<u>\$ 0.28</u>	<u>\$ 0.79</u>	<u>\$ 0.99</u>

Outstanding options and warrants of 512,301 were not factored into the calculation of dilutive stock options because they were anti-dilutive.

#### 13. SHARE-BASED COMPENSATION

On December 31, 2009, the Company had three share-based compensation plans, which are described below.

During 1992, the Bank established a Stock Option Plan for which shares are reserved for issuance to employees and directors under incentive and nonstatutory agreements. The Company assumed all obligations under this plan as of November 15, 2000, and options to purchase shares of the Company's common stock were substituted for options to purchase shares of common stock of the Bank. Outstanding options under this plan are exercisable until their expiration, however, no new options will be granted under this plan.

On November 15, 2000, the Company adopted, and subsequently amended on December 20, 2000, the Central Valley Community Bancorp 2000 Stock Option Plan (2000 Plan) for which 747,934 shares remain reserved for issuance for options already granted to employees and directors under incentive and nonstatutory agreements and 14,361 remain reserved for future grants as of December 31, 2009. The plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the option price must be paid in full at the time it is exercised. The options under the plan expire on dates determined by the Board of Directors, but not later than 10 years from the date of grant. The vesting period is determined by the Board of Directors and is generally over five years.

In May 2005, the Company adopted the Central Valley Community Bancorp 2005 Omnibus Incentive Plan (2005 Plan). The plan provides for awards in the form of incentive stock options, non-statutory stock options, stock appreciation rights, and restricted stock. The plan also allows for performance awards that may be in the form of cash or shares of the Company, including restricted stock. The maximum number of shares that can be issued with respect to all awards under the plan is 476,000. Currently under the 2005 Plan, there are 42,000 shares reserved for issuance for options already granted to employees and 434,000 remain reserved for future grants as of December 31, 2009. The 2005 plan requires that the exercise price may not be less than the fair market value of the stock at the date the option is granted, and that the option price must be paid in full at the time it is exercised. The options and awards under the plan expire on dates determined by the Board of Directors, but not later than 10 years from the date of grant. The vesting period for the options and option related stock appreciation rights is determined by the Board of Directors and is generally over five years.

In 2009, options to purchase 13,500 shares of the Company's common stock were granted at exercise prices of between \$5.06 and \$6.40 from the 2005 Plan. All options were granted with an exercise price equal to the market value on the grant date.

In December 2008, the Company cancelled options to purchase 90,550 shares of the Company's common stock previously granted from the 2000 Plan on October 17, 2007 and options to purchase 15,000 shares of the Company's common stock previously granted from the 2005 Plan on October 1, 2007 and, on December 17, 2008, granted options to purchase 90,550 shares of the Company's common stock from the 2000 Plan and options to purchase 15,000 shares of the Company's common stock from the 2005 Plan at an exercise price of \$6.70, the fair market value on the grant date. Also, from the 2005 Plan, new options to purchase 15,000 shares of the Company's common stock were granted in 2008 at an exercise price of \$6.70.

In 2007, options to purchase 78,900 shares of the Company's common stock were granted at an exercise price of \$12.00 from the Plan. From the 2005 Plan, options to purchase 15,000 shares of the Company's common stock were granted in 2007 at an exercise price of \$12.20.

For the years ended December 31, 2009, 2008 and 2007, the compensation cost recognized for stock option compensation was \$284,000, \$100,000 and \$221,000, respectively. The recognized tax benefit for stock option compensation expense was \$44,000, \$50,000 and \$42,000 for 2009, 2008 and 2007, respectively.

## Central Valley Community Bancorp and Subsidiary

### Notes To Consolidated Financial Statements (Continued)

#### 13. SHARE-BASED COMPENSATION (Continued)

A summary of the combined activity of the Plans for the years ended December 31, 2009 and 2008 follows:

	Number of Stock Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
(Dollars in thousands, except per share amounts)				
Options outstanding at January 1, 2007	899,834	\$ 6.45		
Options granted	187,800	\$ 13.15		
Options exercised	(124,460)	\$ 4.55		
Options canceled	<u>(101,340)</u>	<u>\$ 14.69</u>		
Options outstanding at December 31, 2007	<u>861,834</u>	<u>\$ 7.22</u>	<u>4.77</u>	<u>\$ 3,712</u>
Options vested or expected to vest at December 31, 2008	<u>821,138</u>	<u>\$ 6.92</u>	<u>6.71</u>	<u>\$ 3,541</u>
Options exercisable at December 31, 2007	<u>662,324</u>	<u>\$ 5.64</u>	<u>3.68</u>	<u>\$ 3,689</u>
Options outstanding at January 1, 2008	861,834			
Options granted	120,550	\$ 6.70		
Options exercised	(44,003)	\$ 4.71		
Options canceled	<u>(114,500)</u>	<u>\$ 12.10</u>		
Options outstanding at December 31, 2008	<u>823,881</u>	<u>\$ 6.60</u>	<u>4.03</u>	<u>\$ 990</u>
Options vested or expected to vest at December 31, 2008	<u>799,710</u>	<u>\$ 6.50</u>	<u>4.95</u>	<u>\$ 990</u>
Options exercisable at December 31, 2008	<u>673,381</u>	<u>\$ 6.03</u>	<u>3.18</u>	<u>\$ 990</u>
Options outstanding at January 1, 2009	823,881			
Options granted	13,500	\$ 5.21		
Options exercised	(42,522)	\$ 4.11		
Options canceled	<u>(4,925)</u>	<u>\$ 8.10</u>		
Options outstanding at December 31, 2009	<u>789,934</u>	<u>\$ 6.70</u>	<u>3.29</u>	<u>\$ 668</u>
Options vested or expected to vest at December 31, 2009	<u>757,726</u>	<u>\$ 6.60</u>	<u>4.46</u>	<u>\$ 668</u>
Options exercisable at December 31, 2009	<u>679,507</u>	<u>\$ 6.46</u>	<u>2.65</u>	<u>\$ 668</u>

The weighted-average grant-date fair value of options granted during 2009, 2008 and 2007 was \$1.33, \$2.00 and \$5.49, respectively.

The total intrinsic value of options exercised in the years ended December 31, 2009, 2008 and 2007 was \$51,000, \$142,000 and \$962,000, respectively.

Cash received from options exercised for the years ended December 31, 2009, 2008 and 2007 was \$175,000, \$207,000 and \$565,000, respectively. The actual tax benefit realized for the tax deductions from options exercised totaled \$7,000, \$57,000 and \$395,000 for the years ended December 31, 2009, 2008 and 2007, respectively.

As of December 31, 2009, there was \$452,000 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the 2000 and 2005 Plans. The cost is expected to be recognized over a weighted average period of 2.2 years. The total fair value of options vested was \$252,000 and \$295,000 for the years ended December 31, 2009 and 2008, respectively.

#### 14. EMPLOYEE BENEFITS

##### 401(k) and Profit Sharing Plan

The Bank has established a 401(k) and profit sharing plan. The 401(k) plan covers substantially all employees who have completed a six-month period in which they are credited with at least 1,000 hours of service. Participants in the profit sharing plan are eligible to receive employer contributions after completion of two years of service. Bank contributions to the profit sharing plan are determined at the discretion of the Board of Directors. Participants are automatically vested 100% in all employer contributions. The Bank did not contribute to the profit sharing plan in 2009 and contributed \$157,000 and \$260,000 to the profit sharing plan in 2008 and 2007, respectively.

Additionally, the Bank may elect to make a matching contribution to the participants' 401(k) plan accounts. The amount to be contributed is announced by the Bank at the beginning of the plan year. For the years ended December 31, 2009, 2008 and 2007, the Bank made a 100% matching contribution on all deferred amounts up to 3% of eligible compensation and a 50% matching contribution on all deferred amounts above 3% to a maximum of 5%. For the years ended December 31, 2009, 2008 and 2007, the Bank made matching contributions totaling \$301,000, \$254,000 and \$241,000, respectively.

# Central Valley Community Bancorp and Subsidiary

## Notes To Consolidated Financial Statements (Continued)

### 14. EMPLOYEE BENEFITS (Continued)

#### Deferred Compensation Plan

The Bank has a nonqualified Deferred Compensation Plan which provides directors with an unfunded, deferred compensation program. Under the plan, eligible participants may elect to defer some or all of their current compensation or director fees. Deferred amounts earn interest at an annual rate determined by the Board of Directors (5.00% at December 31, 2009). At December 31, 2009 and 2008, the total net deferrals included in accrued interest payable and other liabilities were \$1,992,000 and \$1,776,000, respectively.

In connection with the implementation of the above plan, single premium universal life insurance policies on the life of each participant were purchased by the Bank, which is beneficiary and owner of the policies. The cash surrender value of the policies totaled \$3,006,000, \$2,909,000 and \$2,813,000 at December 31, 2009, 2008 and 2007, respectively. Income recognized on these policies, net of related expenses, for the years ended December 31, 2009, 2008 and 2007 was \$97,000, \$99,000 and \$93,000, respectively.

#### Salary Continuation Plans

The Board of Directors approved salary continuation plans for certain key executives during 2002 and subsequently amended the plans in 2006. Under these plans, the Bank is obligated to provide the executives with annual benefits for fifteen years after retirement. These benefits are substantially equivalent to those available under split-dollar life insurance policies purchased by the Bank on the life of the executives. In addition, the estimated present value of these future benefits are accrued from the effective date of the plans until the executives' expected retirement date based on a discount rate of 6.00%. The expense recognized under these plans for the years ended December 31, 2009, 2008 and 2007 totaled \$407,000, \$389,000 and \$367,000, respectively. Accrued compensation payable under the salary continuation plan totaled \$3,201,000 and \$2,865,000 at December 31, 2009 and 2008, respectively.

In connection with these plans, the Bank purchased single premium life insurance policies with cash surrender values totaling \$4,214,000 and \$4,064,000 at December 31, 2009 and 2008, respectively. Income recognized on these policies, net of related expense, for the years ended December 31, 2009, 2008 and 2007 totaled \$155,000, \$157,000 and \$133,000, respectively.

In connection with the acquisition of Service 1<sup>st</sup> Bank, the Bank assumed a liability for the estimated present value of future benefits payable to former key executives of Service 1<sup>st</sup>. The liability relates to change in control benefits associated with Service 1<sup>st</sup>'s salary continuation plans. The benefits are payable to the individuals when they reach retirement age. At December 31, 2009 and 2008, the total amount of the liability was \$1,581,000 and \$1,606,000, respectively. Expense recognized by the Bank in 2009 and 2008 associated with these plans was \$22,000 and \$5,000, respectively. These benefits are substantially equivalent to those available under split-dollar life insurance policies acquired. These single premium life insurance policies had cash surrender values totaling \$3,778,000 and \$3,835,000 at December 31, 2009 and 2008, respectively. Income recognized on these policies, net of related expenses, for the year ended December 31, 2009 and 2008 was \$139,000 and \$12,000, respectively.

The current annual tax-free interest rate on all life insurance policies is 5.5%.

### 15. LOANS TO RELATED PARTIES

During the normal course of business, the Bank enters into loans with related parties, including executive officers and directors. These loans are made with substantially the same terms, including rates and collateral, as loans to unrelated parties. The following is a summary of the aggregate activity involving related party borrowers (in thousands):

Balance, January 1, 2009	\$	791
Disbursements		(164)
Amounts repaid		<u>210</u>
Balance, December 31, 2009	\$	<u>837</u>
Undisbursed commitments to related parties, December 31, 2009	\$	<u>2,123</u>

### 16. COMPREHENSIVE INCOME

Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income (loss) that historically has not been recognized in the calculation of net income. The Company's only source of other comprehensive income (loss) is unrealized gains and losses on the Company's available-for-sale investment securities. Total comprehensive income and the components of accumulated other comprehensive income (loss) are presented in the consolidated statement of changes in shareholders' equity.

**Central Valley Community Bancorp and Subsidiary**  
Notes To Consolidated Financial Statements (Continued)

16. **COMPREHENSIVE INCOME** (Continued)

At December 31, 2009, 2008 and 2007, the Company held securities classified as available-for-sale which had net unrealized gains or losses as follows:

	Before Tax	Tax Expense (In thousands)	After Tax
<u>For the Year Ended December 31, 2009</u>			
Other comprehensive loss:			
Unrealized holding losses	\$ (1,971)	\$ 788	\$ (1,183)
Less reclassification adjustment for net gains included in net income	<u>767</u>	<u>(307)</u>	<u>460</u>
Total other comprehensive loss	<u>\$ (2,738)</u>	<u>\$ 1,095</u>	<u>\$ (1,643)</u>
<u>For the Year Ended December 31, 2008</u>			
Other comprehensive income:			
Unrealized holding losses	\$ 244	\$ (97)	\$ 147
Less reclassification adjustment for net gains included in net income	<u>165</u>	<u>(66)</u>	<u>99</u>
Total other comprehensive income	<u>\$ 79</u>	<u>\$ (31)</u>	<u>\$ 48</u>
<u>For the Year Ended December 31, 2007</u>			
Other comprehensive income:			
Unrealized holding gains	\$ 493	\$ (198)	\$ 295
Less reclassification adjustment for net gains included in net income	<u>64</u>	<u>(26)</u>	<u>38</u>
Total other comprehensive income	<u>\$ 429</u>	<u>\$ (172)</u>	<u>\$ 257</u>

17. **PARENT ONLY CONDENSED FINANCIAL STATEMENTS**

**CONDENSED BALANCE SHEETS**

December 31, 2009 and 2008  
(In thousands)

	<u>2009</u>	<u>2008</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 859	\$ 1,087
Investment in Subsidiary	95,370	77,307
Other assets	<u>301</u>	<u>2,384</u>
Total assets	<u>\$ 96,530</u>	<u>\$ 80,778</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Liabilities:		
Junior subordinated debentures due to subsidiary grantor trust	\$ 5,155	\$ 5,155
Other liabilities	<u>152</u>	<u>248</u>
Total liabilities	<u>5,307</u>	<u>5,403</u>
Shareholders' equity:		
Preferred stock, Series A	6,819	-
Preferred stock, Series B	1,317	-
Common stock	37,611	30,479
Retained earnings	46,931	44,708
Accumulated other comprehensive income, net of taxes	<u>(1,455)</u>	<u>188</u>
Total shareholders' equity	<u>91,223</u>	<u>75,375</u>
Total liabilities and shareholders' equity	<u>\$ 96,530</u>	<u>\$ 80,778</u>

**Central Valley Community Bancorp and Subsidiary**  
**Notes To Consolidated Financial Statements (Continued)**

17. **PARENT ONLY CONDENSED FINANCIAL STATEMENTS** (Continued)

**CONDENSED STATEMENTS OF INCOME**

For the Years Ended December 31, 2009, 2008 and 2007  
(In thousands)

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Income:			
Dividends declared by Subsidiary - eliminated in consolidation	\$ -	\$ 6,100	\$ 3,600
Other income	<u>13</u>	<u>2</u>	<u>1</u>
Total income	<u>13</u>	<u>6,102</u>	<u>3,601</u>
Expenses:			
Interest on junior subordinated deferrable interest debentures	129	46	-
Professional fees	30	104	104
Other expenses	<u>295</u>	<u>231</u>	<u>281</u>
Total expenses	<u>454</u>	<u>381</u>	<u>385</u>
(Loss) income before equity in undistributed net income of Subsidiary	(441)	5,721	3,216
Equity in undistributed net income of Subsidiary, net of distributions	<u>2,871</u>	<u>(692)</u>	<u>2,942</u>
Income before income tax benefit	2,430	5,029	6,158
Income tax benefit	<u>158</u>	<u>110</u>	<u>122</u>
Net income	2,588	5,139	6,280
Preferred stock dividend and accretion of discount	<u>365</u>		
Income available to common shareholders	<u>\$ 2,223</u>	<u>\$ 5,139</u>	<u>\$ 6,280</u>

**Central Valley Community Bancorp and Subsidiary**  
**Notes To Consolidated Financial Statements (Continued)**

17. PARENT ONLY CONDENSED FINANCIAL STATEMENTS (Continued)

**CONDENSED STATEMENTS OF CASH FLOWS**

For the Years Ended December 31, 2009, 2008 and 2007  
(In thousands)

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:			
Net income	\$ 2,588	\$ 5,139	\$ 6,280
Adjustments to reconcile net income to net cash provided by operating activities:			
Undistributed net income of Subsidiary, net of distributions	(2,871)	692	(2,942)
Stock-based compensation	284	100	221
Tax benefit from exercise of stock options	(7)	(57)	(395)
Decrease in other assets	1,765	265	492
(Decrease) increase in other liabilities	(140)	116	(108)
Provision for deferred income taxes	68	-	22
Net cash provided by operating activities	<u>1,687</u>	<u>6,255</u>	<u>3,570</u>
Cash flows used in investing activities:			
Investment in Subsidiary	<u>(16,578)</u>	<u>(6,233)</u>	<u>-</u>
Cash flows from financing activities:			
Repayments of borrowings from other financial institution	-	-	(1,250)
Net proceeds from issuance of Series B preferred stock	1,317	-	-
Proceeds from issuance of Series A preferred stock and warrants	7,000	-	-
Net proceeds from issuance of common stock	6,441	-	-
Share repurchase and retirement	-	(56)	(2,707)
Proceeds from exercise of stock options	175	207	565
Tax benefit from exercise of stock options	7	57	395
Cash dividends paid	<u>(277)</u>	<u>(598)</u>	<u>(595)</u>
Net cash provided by (used in) financing activities	<u>14,663</u>	<u>(390)</u>	<u>(3,592)</u>
Decrease in cash and cash equivalents	(228)	(368)	(22)
Cash and cash equivalents at beginning of year	<u>1,087</u>	<u>1,455</u>	<u>1,477</u>
Cash and cash equivalents at end of year	<u>\$ 859</u>	<u>\$ 1,087</u>	<u>\$ 1,455</u>
Cash paid during the year for interest	\$ 182	\$ -	\$ 67
Non-cash investing activities:			
Net change in unrealized (loss) gain on available-for-sale investment securities	\$ (2,738)	\$ 79	\$ 429
Fair market value of common stock issued in acquisition of subsidiary	\$ -	\$ 16,600	\$ -
Non-cash financing activities:			
Accrued preferred stock dividends	\$ 44	\$ -	\$ -

## Report Of Independent Registered Public Accounting Firm

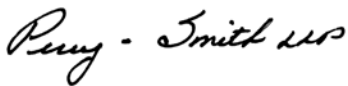
The Shareholders and Board of Directors  
Central Valley Community Bancorp and Subsidiary

We have audited the accompanying consolidated balance sheets of Central Valley Community Bancorp and subsidiary as of December 31, 2009 and 2008 and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2009. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provided a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Central Valley Community Bancorp and subsidiary as of December 31, 2009 and 2008 and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

We were not required or engaged to examine the effectiveness of Central Valley Community Bancorp and subsidiary's internal control over financial reporting as of December 31, 2009 and, accordingly, we do not express an opinion thereon.



Sacramento, California  
March 31, 2010

## Selected Financial Data

### Years Ended December 31, (In thousands, except per share amounts)

Statements of Income	2009	2008	2007	2006	2005
Total interest income	\$ 40,734	\$ 31,845	\$ 32,566	\$ 30,932	\$ 26,070
Total interest expense	<u>6,627</u>	<u>7,278</u>	<u>8,058</u>	<u>6,559</u>	<u>4,139</u>
Net interest income before provision for credit losses	34,107	24,567	24,508	24,373	21,931
Provision for credit losses	<u>10,514</u>	<u>1,290</u>	<u>480</u>	<u>800</u>	<u>510</u>
Net interest income after provision for credit losses	23,593	23,277	24,028	23,573	21,421
Non-interest income	<u>5,850</u>	<u>5,190</u>	<u>4,518</u>	<u>5,177</u>	<u>4,009</u>
	29,443	28,467	28,546	28,750	25,430
Non-interest expenses	<u>27,531</u>	<u>20,976</u>	<u>19,099</u>	<u>18,541</u>	<u>16,042</u>
Income before provision for income taxes	1,912	7,491	9,447	10,209	9,388
(Benefit) Provision for income taxes	<u>(676)</u>	<u>2,352</u>	<u>3,167</u>	<u>3,298</u>	<u>3,344</u>
Net income	2,588	5,139	6,280	6,911	6,044
Preferred stock dividends and accretion of discount	<u>365</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net income available to common shareholders	<u>\$ 2,223</u>	<u>\$ 5,139</u>	<u>\$ 6,280</u>	<u>\$ 6,911</u>	<u>\$ 6,044</u>
Basic earnings per share	<u>\$ 0.29</u>	<u>\$ 0.83</u>	<u>\$ 1.05</u>	<u>\$ 1.16</u>	<u>\$ 1.03</u>
Diluted earnings per share	<u>\$ 0.28</u>	<u>\$ 0.79</u>	<u>\$ 0.99</u>	<u>\$ 1.07</u>	<u>\$ 0.94</u>
Cash dividends declared per common share	<u>\$ 0.00</u>	<u>\$ 0.10</u>	<u>\$ 0.10</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>

### December 31, (In thousands)

Balances at end of year:	2009	2008	2007	2006	2005
Investment securities, Federal funds sold and deposits in other banks	\$ 232,142	\$ 194,215	\$ 98,909	\$ 128,463	\$ 136,340
Net loans	449,007	477,015	337,241	318,853	298,463
Total deposits	640,167	635,058	402,562	440,627	430,989
Total assets	765,488	752,713	483,685	500,059	483,677
Shareholders' equity	91,223	75,375	54,194	49,778	41,523
Earning assets	696,914	681,280	441,825	453,211	440,646

### Average balances:

Investment securities, Federal funds sold and deposits in other banks	\$ 199,425	\$ 125,932	\$ 103,253	\$ 125,702	\$ 135,679
Net loans	473,850	362,333	327,665	300,591	274,348
Total deposits	632,263	445,285	417,691	414,310	407,188
Total assets	752,509	541,789	477,321	470,221	455,680
Shareholders' equity	83,400	58,251	51,754	45,564	38,691
Earning assets	671,906	492,414	436,564	431,368	414,257

### Unaudited Quarterly Statement of Operations

(Dollars in thousands except per share amounts)

	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008	Q2 2008	Q1 2008
Net interest income	\$ 8,220	\$ 8,654	\$ 8,748	\$ 8,485	\$ 6,969	\$ 6,023	\$ 5,726	\$ 5,849
Provision for credit losses	<u>2,864</u>	<u>3,233</u>	<u>2,500</u>	<u>1,917</u>	<u>385</u>	<u>635</u>	<u>135</u>	<u>135</u>
Net interest income after provision for credit losses	5,356	5,421	6,248	6,568	6,584	5,388	5,591	5,714
Total non-interest income	1,103	1,608	1,401	1,738	1,296	1,382	1,274	1,238
Total non-interest expense	6,616	6,946	7,129	6,840	6,054	4,984	4,966	4,972
Provision for income taxes	<u>(643)</u>	<u>(296)</u>	<u>56</u>	<u>207</u>	<u>521</u>	<u>572</u>	<u>584</u>	<u>675</u>
Net income	<u>\$ 486</u>	<u>\$ 379</u>	<u>\$ 464</u>	<u>\$ 1,259</u>	<u>\$ 1,305</u>	<u>\$ 1,214</u>	<u>\$ 1,315</u>	<u>\$ 1,305</u>
Net income available to common shareholders	<u>\$ 416</u>	<u>\$ 268</u>	<u>\$ 329</u>	<u>\$ 1,210</u>	<u>\$ 1,305</u>	<u>\$ 1,214</u>	<u>\$ 1,315</u>	<u>\$ 1,305</u>
Basic earnings per share	<u>\$ 0.05</u>	<u>\$ 0.04</u>	<u>\$ 0.04</u>	<u>\$ 0.16</u>	<u>\$ 0.19</u>	<u>\$ 0.20</u>	<u>\$ 0.22</u>	<u>\$ 0.22</u>



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

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

Management's discussion and analysis should be read in conjunction with the Company's audited Consolidated Financial Statements, including the Notes thereto, in Item 8 of this Annual Report.

Certain matters discussed in this report constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements contained herein that are not historical facts, such as statements regarding the Company's current business strategy and the Company's plans for future development and operations, are based upon current expectations. These statements are forward-looking in nature and involve a number of risks and uncertainties. Such risks and uncertainties include, but are not limited to (1) significant increases in competitive pressure in the banking industry; (2) the impact of changes in interest rates, a decline in economic conditions at the international, national or local level on the Company's results of operations, the Company's ability to continue its internal growth at historical rates, the Company's ability to maintain its net interest margin, and the quality of the Company's earning assets; (3) changes in the regulatory environment; (4) fluctuations in the real estate market; (5) changes in business conditions and inflation; (6) changes in securities markets (7) risks associated with acquisitions, relating to difficulty in integrating combined operations and related negative impact on earnings, and incurrence of substantial expenses. Therefore, the information set forth in such forward-looking statements should be carefully considered when evaluating the business prospects of the Company.

When the Company uses in this Annual Report the words "anticipate," "estimate," "expect," "project," "intend," "commit," "believe" and similar expressions, the Company intends to identify forward-looking statements. Such statements are not guarantees of performance and are subject to certain risks, uncertainties and assumptions, including those described in this Annual Report. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, expected, projected, intended, committed or believed. The future results and shareholder values of the Company may differ materially from those expressed in these forward-looking statements. Many of the factors that will determine these results and values are beyond the Company's ability to control or predict. For those statements, the Company claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

## INTRODUCTION

Central Valley Community Bancorp (NASDAQ: CVCY) (the Company) was incorporated on February 7, 2000. The formation of the holding company offered the Company more flexibility in meeting the long-term needs of customers, shareholders, and the communities it serves. The Company currently has one bank subsidiary, Central Valley Community Bank (the Bank) and one business trust subsidiary, Service 1<sup>st</sup> Capital Trust 1. The Bank of Madera County (BMC) was merged with and into the Bank on January 1, 2005. BMC had two branches in Madera County which continue to be operated by the Bank. After the close of business on November 12, 2008, Service 1<sup>st</sup> Bancorp (Service 1<sup>st</sup>) was merged with and into the Company, and Service 1<sup>st</sup> Bank was merged with and into the Bank. Service 1<sup>st</sup> Bank had three branches in Stockton, Tracy, and Lodi which continue to be operated by the Bank. Service 1<sup>st</sup> Capital Trust 1 (the Trust) is a business trust formed for the purpose of issuing trust preferred securities. The Company succeeded to all the rights and obligations of Service 1<sup>st</sup> in connection with the acquisition of Service 1<sup>st</sup>. The Trust is a subsidiary of the Company. The Company's market area includes the central valley area from Sacramento, California to Bakersfield, California.

During 2009, we focused on asset quality and capital adequacy due to the uncertainty created by the recession. We also focused on assuring that competitive products and services were made available to our clients while adjusting to the many new laws and regulations that affect the banking industry. In 2009, we opened a new full service office in Merced, California and relocated our Oakhurst office to a new smaller facility in a more desirable location. During 2008 the Company acquired Service 1<sup>st</sup> Bancorp and its banking subsidiary adding three strategically located branches and we relocated our Herndon and Fowler branch from an in-store location to a new larger facility. During 2007, the Bank opened a loan production office in Modesto, California, and relocated our Kerman branch to a new larger facility. During 2006, the Bank opened two full service retail offices in Fresno, one in the downtown area and one in the Sunnyside area of Fresno. In 2006, the Company consolidated its administrative offices into a single location in Fresno and opened a limited service branch there. The Bank now operates 16 full-service branches, one limited service branch and one loan production office.

## ECONOMIC CONDITIONS

The economy in California's Central Valley has been negatively impacted by the recession that began in 2007 and the related real estate market and the slowdown in residential construction. The recession has impacted most industries in our market area. During the past two years, housing values throughout the nation and especially in the Central Valley have decreased dramatically, which in turn has negatively affected the personal net worth of much of the population in our service area. Housing in the Central Valley continues to be relatively more affordable than the major metropolitan areas in California.

Agriculture and agricultural related businesses remain a critical part of the Central Valley's economy. The Valley's agricultural production is widely diversified, producing nuts, vegetables, fruit, cattle, dairy products, and cotton. The continued future success of agriculture related businesses is highly dependant on the availability of water and is subject to fluctuation in worldwide commodity prices and demand.

## OVERVIEW

Diluted earnings per share (EPS) for the year ended December 31, 2009 was \$0.28 compared to \$0.79 and \$0.99 for the years ended December 31, 2008 and 2007, respectively. Net income for 2009 was \$2,588,000 compared to \$5,139,000 and \$6,280,000 for the years ended December 31, 2008 and 2007, respectively. The decreases in net income and EPS were due primarily to increases in the provision for credit losses recorded in 2009 and 2008. Total assets at December 31, 2009 were \$765,488,000 compared to \$752,713,000 at December 31, 2008.

Return on average equity for 2009 was 3.10% compared to 8.82% and 12.13% for 2008 and 2007, respectively. Return on average assets for 2009 was 0.34% compared to 0.95% and 1.32% for 2008 and 2007, respectively. Total equity was \$91,223,000 at December 31, 2009 compared to \$75,375,000 at December 31, 2008. The increase in 2009 assets and equity was mainly due to capital raising activities, including our participation in the Treasury Capital Purchase Program under the Emergency Economic Stabilization Act under which the Company issued preferred stock and a Warrant to issue common stock in consideration of \$7,000,000 and the private sale of equity to certain accredited investors who purchased preferred and common shares for a total of \$8,000,000. The primary driver in the growth in total assets and equity at December 31, 2008 compared to 2007 was the acquisition on November 12, 2008 of Service 1<sup>st</sup> Bancorp and its subsidiary bank – Service 1<sup>st</sup> Bank (Service 1<sup>st</sup>).

As a result of both the acquisition of Service 1<sup>st</sup> and organic growth, total loans continued to increase during 2009. Average total loans increased \$115,449,000 or 31.5% to \$482,458,000 in 2009 compared to \$367,009,000 in 2008. As a result of the recession during 2008 and the acquisition of Service 1<sup>st</sup> the Company experienced an increase in the level of nonperforming assets. In 2009, we recorded a provision for credit losses of \$10,514,000 compared to \$1,290,000 in 2008 and \$480,000 in 2007. The Company had nonperforming assets totaling \$21,838,000 at December 31, 2009. Nonperforming assets included nonaccrual loans totaling \$18,959,000, other real estate owned of \$2,832,000 and \$47,000 in other assets. At December 31, 2008 we had \$15,750,000 in nonaccrual loans and no other real estate owned. Of the nonperforming assets at December 31, 2009, 45.2% or \$9,874,000 related to former Service 1<sup>st</sup> Bank loans. Net charge-offs for 2009 were \$7,537,000 compared to \$740,000 for 2008 and \$402,000 for 2007. Of the total charge offs in 2009, \$4,828,000 or 60.9% were from loans acquired from Service 1<sup>st</sup>. Refer to "Asset Quality" below for further information.

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

## OVERVIEW (continued)

### Key Factors in Evaluating Financial Condition and Operating Performance

As a publicly traded community bank holding company, we focus on several key factors including:

- Return to our stockholders;
- Return on average assets;
- Development of core earnings, including net interest income and non-interest income;
- Asset quality;
- Asset growth;
- Capital adequacy;
- Operating efficiency; and
- Liquidity

#### *Return to Our Stockholders*

Our return to our stockholders is measured in the form of return on average equity (ROE). Our ROE was 3.10% for the year ended 2009 compared to 8.82% and 12.13% for the years ended 2008 and 2007, respectively. The decrease in ROE for 2009 is primarily due to the decrease in our net income and the overall increase in the level of capital due to the issuance of preferred stock in connection with the U. S. Treasury Capital Purchase Program, and a private placement of our common and preferred stock in 2009. Our net income for the year ended December 31, 2009 decreased \$2,551,000 compared to a decrease of \$1,141,000 and \$631,000 for 2008 and 2007, respectively. During 2009 net income decreased primarily due to an increase in the provision for credit losses. Non-interest expenses increased due to higher occupancy and personnel expenses from our Service 1<sup>st</sup> acquisition and expansion in 2009 and 2008, and higher other operating expenses. The increase in other operating expenses included a \$1,274,000 increase in FDIC assessments and expenses associated with nonperforming assets including a \$479,000 increase in other real estate owned expenses, an increase in legal expenses of \$189,000, a \$120,000 increase in appraisal fees, and a \$50,000 increase in repossession expenses. Net interest income and non-interest income also increased in 2009. During 2009, our net interest margin (NIM) increased 18 basis points compared to 2008. Basic EPS was \$0.29 for 2009 compared to \$0.83 and \$1.05 for 2008 and 2007, respectively. Diluted EPS was \$0.28 for 2009 compared to \$0.79 and \$0.99 for 2008 and 2007, respectively. The decrease in EPS in 2009 was due primarily to the decrease in net income and the increase in weighted average shares outstanding as well as the impact of dividends on preferred stock and accretion of the preferred stock discount.

#### *Return on Average Assets*

Our return on average assets (ROA) is a measure we use to compare our performance with other banks and bank holding companies. Our ROA for the year ended 2009 decreased to 0.34% compared to 0.95% and 1.32% for the years ended December 31, 2008 and 2007, respectively. The 2009 decrease in ROA is due to the decrease in net income compounded by our increase in average assets. Annualized ROA for our peer group was (0.59)% at September 30, 2009. Peer group information from SNL Financial data includes bank holding companies in central California with assets from \$300M to \$950M and not subchapter S.

#### *Development of Core Earnings*

Over the past several years, we have focused on not only our net income, but improving the consistency of our core earnings in order to create more predictable future earnings and reduce the effect of changes in our operating environment on our net income. Specifically, we have focused on net interest income through a variety of processes, including increases in average interest-earning assets through loan generation and retention. We minimized the effects of the recent interest rate decline on our net interest margin by focusing on core deposits and managing the cost of funds. Our net interest margin (fully tax equivalent basis) was 5.31% for the year ended December 31, 2009, compared to 5.13% and 5.74% for the years ended December 31, 2008 and 2007, respectively. The increase in net interest margin compared to 2008 is principally due to a decrease in our cost of funds which was greater than the decrease in our yield on earning assets. In comparing the two periods, the effective yield on total earning assets decreased 31 basis points, while the cost of total interest-bearing liabilities decreased 81 basis points and the cost of total deposits decreased 49 basis points. Our cost of total deposits in 2009 was 0.93% compared to 1.42% for the same period in 2008 and 1.89% for the year ended December 31, 2007. Our net interest income before provision for credit losses increased \$9,540,000 or 38.8% to \$34,107,000 for the year ended 2009 compared to \$24,567,000 and \$24,508,000 for the years ended 2008 and 2007, respectively.

Our non-interest income is generally made up of service charges and fees on deposit accounts, fee income from loan placements, appreciation in cash surrender value of bank owned life insurance, and net gains from sales and calls of investment securities. Non-interest income in 2009 increased \$660,000 or 12.7% to \$5,850,000 compared to \$5,190,000 in 2008 and \$4,518,000 in 2007. Customer service charges increased \$159,000 or 4.8% to \$3,509,000 in 2009 compared to \$3,350,000 and \$2,859,000 in 2008 and 2007, respectively, mainly due to an increase in fee rates and in the number of transaction accounts. Further detail on non-interest income is provided below.

#### *Asset Quality*

For all banks and bank holding companies, asset quality has a significant impact on the overall financial condition and results of operations. Asset quality is measured in terms of percentage of total loans and total assets, and is a key element in estimating the future earnings of a company. We had nonperforming loans totaling \$18,959,000 or 4.13% of gross loans as of December 31, 2009 and \$15,750,000 or 3.25% of gross loans as of December 31, 2008. At December 31, 2009, other nonperforming assets included other real estate owned totaling \$2,832,000 and other assets of \$47,000. We did not have any other nonperforming assets at December 31, 2008. At December 31, 2009, \$7,410,000 of nonaccrual loans and \$2,464,000 of OREO related to the loan portfolio acquired from Service 1<sup>st</sup>. Management maintains certain loans that have been brought current by the borrower (less than 30 days delinquent) on nonaccrual status until such time as management has determined that the loans are likely to remain current in future periods.

#### *Asset Growth*

As revenues from both net interest income and non-interest income are a function of asset size, the continued growth in assets has a direct impact in increasing net income and therefore ROE and ROA. The majority of our assets are loans and investment securities, and the majority of our liabilities are deposits, and therefore the ability to generate deposits as a funding source for loans and investments is fundamental to our asset growth. The acquisition of Service 1<sup>st</sup> on November 12, 2008 contributed to the growth of our asset size in 2009. Total assets increased 1.7% during 2009 to \$765,488,000 as of December 31, 2009 from \$752,713,000 as of December 31, 2008. Total gross loans decreased 5.2% to \$459,207,000 as of December 31, 2009, compared to \$484,238,000 at December 31, 2008. Total investment securities and Federal funds sold increased 1.7% to \$197,598,000 as of December 31, 2009 compared to \$194,215,000 as of December 31, 2008. Total deposits increased 0.8% to \$640,167,000 as of December 31, 2009 compared to \$635,058,000 as of December 31, 2008. Our loan to deposit ratio at December 31, 2009 was 71.7% compared to 76.3% at December 31, 2008. The loan to deposit ratio of our peers was 88.0% at September 30, 2009.

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

## OVERVIEW (continued)

### *Capital Adequacy*

At December 31, 2009, we had a total capital to risk-weighted assets ratio of 13.54%, a Tier 1 risk-based capital ratio of 12.28% and a leverage ratio of 9.30%. At December 31, 2008, we had a total capital to risk-weighted assets ratio of 10.57%, a Tier 1 risk-based capital ratio of 9.33% and a leverage ratio of 8.67%. At December 31, 2009, on a stand-alone basis, the Bank had a total risk-based capital ratio of 13.38%, a Tier 1 risk based capital ratio of 12.12% and a leverage ratio of 9.20%. At December 31, 2008, the Bank had a total risk-based capital ratio of 10.05%, Tier 1 risk-based capital of 8.81% and a leverage ratio of 8.18%. The improvement in 2009 is due to an increase in risk adjusted capital that was relatively greater than the relative growth in risk weighted assets. Note 12 of the audited Consolidated Financial Statements provides more detailed information concerning the Company's capital amounts and ratios.

### *Operating Efficiency*

Operating efficiency is the measure of how efficiently earnings before taxes are generated as a percentage of revenue. The Company's efficiency ratio (operating expenses, excluding amortization of intangibles, and foreclosed property expense divided by net interest income plus non-interest income, excluding net gains from sale of securities) was 67.3% for 2009 compared to 70.1% for 2008 and 65.2% for 2007. The improvement in the efficiency ratio in 2009 is due to an increase in net interest income partially offset by an increase in operating expenses. The deterioration in the efficiency ratio in 2008 was due to the increase in operating expenses due to our acquisition and expansion in 2008. The Company's net interest income before provision for credit losses plus non-interest income increased 34.3% to \$39,957,000 in 2009 compared to \$29,757,000 in 2008 and \$29,026,000 in 2007, while operating expenses increased 31.3% in 2009, 9.8% in 2008, and 3.0% in 2007.

### *Liquidity*

Liquidity management involves our ability to meet cash flow requirements arising from fluctuations in deposit levels and demands of daily operations, which include providing for customers' credit needs, funding of securities purchases, and ongoing repayment of borrowings. Our liquidity is actively managed on a daily basis and reviewed periodically by our management and Directors' Asset/Liability Committee. This process is intended to ensure the maintenance of sufficient funds to meet our needs, including adequate cash flow for off-balance sheet commitments. Our primary sources of liquidity are derived from financing activities which include the acceptance of customer and, to a lesser extent, broker deposits, Federal funds facilities and advances from the Federal Home Loan Bank of San Francisco. We have available unsecured lines of credit with correspondent banks totaling approximately \$39,000,000 and secured borrowing lines of approximately \$113,451,000 with the Federal Home Loan Bank. These funding sources are augmented by collection of principal and interest on loans, the routine maturities and pay downs of securities from our investment securities portfolio, the stability of our core deposits, and the ability to sell investment securities. Primary uses of funds include origination and purchases of loans, withdrawals of and interest payments on deposits, purchases of investment securities, and payment of operating expenses.

We had liquid assets (cash and due from banks, interest-earning deposits in other banks, Federal funds sold and available-for-sale securities) totaling \$245,999,000 or 32.1% of total assets at December 31, 2009 and \$205,236,000 or 27.3% of total assets as of December 31, 2008.

## RESULTS OF OPERATIONS

### **Net Income**

Net income was \$2,588,000 in 2009 compared to \$5,139,000 and \$6,280,000 in 2008 and 2007, respectively. Basic earnings per share were \$0.29, \$0.83, and \$1.05 for 2009, 2008 and 2007, respectively. Diluted earnings per share were \$0.28, \$0.79, and \$0.99 for 2009, 2008 and 2007, respectively. ROE was 3.10% for 2009 compared to 8.82% for 2008 and 12.13% for 2007. ROA for 2009 was 0.34% compared to 0.95% for 2008 and 1.32% for 2007.

The decrease in net income for 2009 compared to 2008 was due mainly to increases in the provision for credit losses and non-interest expenses, partially offset by increases in net interest income and non-interest income, and a decrease in the provision for income taxes. The decrease in net income for 2008 compared to 2007 was due primarily to the 500 basis point reductions in interest rates by the Federal Reserve Bank since September 2007, the increase in the provision for credit losses and the increases in non-interest expenses. These items were offset by the increase in non-interest income, primarily service charges and gains on sales of investment securities and the reduction in the provision for income taxes.

### **Interest Income and Expense**

Net interest income is the most significant component of our income from operations. Net interest income (the interest rate spread) is the difference between the gross interest and fees earned on the loan and investment portfolios and the interest paid on deposits and other borrowings. Net interest income depends on the volume of and interest rate earned on interest-earning assets and the volume of and interest rate paid on interest-bearing liabilities.

The following table sets forth a summary of average balances with corresponding interest income and interest expense as well as average yield and cost information for the periods presented. Average balances are derived from daily balances, and nonaccrual loans are not included as interest-earning assets for purposes of this table. For 2008, average balances reflect the acquisition of Service 1<sup>st</sup> for 13.4% of the year.

# Management's Discussion and Analysis

## of Financial Condition and Results of Operations

### RESULTS OF OPERATIONS (continued)

#### Interest Income and Expense (continued)

#### SCHEDULE OF AVERAGE BALANCES AND AVERAGE YIELDS AND RATES

(Dollars in thousands)

	Year Ended December 31, 2009			Year Ended December 31, 2008		
	Average Balance	Interest Income/Expense	Average Interest Rate	Average Balance	Interest Income/Expense	Average Interest Rate
<b>ASSETS</b>						
Interest-earning deposits in other banks	\$ 3,008	\$ 8	0.27%	\$ 1,318	\$ 39	2.96%
Securities						
Taxable securities	114,465	7,701	6.73%	81,925	4,806	5.87%
Non-taxable securities (1)	<u>64,325</u>	<u>4,632</u>	7.20%	<u>28,709</u>	<u>1,694</u>	5.90%
Total investment securities	178,790	12,333	6.90%	110,634	6,500	5.88%
Federal funds sold	<u>17,627</u>	<u>48</u>	0.27%	<u>13,980</u>	<u>251</u>	1.80%
Total securities	199,425	12,389	6.21%	125,932	6,790	5.39%
Loans (2) (3)	469,341	29,920	6.37%	364,285	25,631	7.06%
Federal Home Loan Bank stock	<u>3,140</u>	<u>7</u>	0.22%	<u>2,197</u>	<u>118</u>	5.37%
<b>Total interest-earning assets</b>	671,906	<u>\$ 42,316</u>	6.30%	492,414	<u>\$ 32,539</u>	6.61%
Allowance for credit losses	(8,608)			(4,676)		
Nonaccrual loans	13,117			2,724		
Other real estate owned	2,553			-		
Cash and due from banks	17,401			17,888		
Bank premises and equipment	6,629			6,043		
Other non-earning assets	<u>49,511</u>			<u>27,396</u>		
<b>Total average assets</b>	<u>\$ 752,509</u>			<u>\$ 541,789</u>		
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>						
Interest-bearing liabilities:						
Savings and NOW accounts	\$ 131,818	\$ 771	0.58%	\$ 79,893	\$ 355	0.45%
Money market accounts	136,104	1,262	0.93%	105,223	2,022	1.93%
Time certificates of deposit, under \$100,000	90,614	1,922	2.12%	69,691	2,085	3.00%
Time certificates of deposit, \$100,000 and over	<u>120,579</u>	<u>1,912</u>	1.59%	<u>58,734</u>	<u>1,878</u>	3.21%
Total interest-bearing deposits	479,115	5,867	1.22%	313,541	6,340	2.03%
Other borrowed funds	<u>29,987</u>	<u>760</u>	2.53%	<u>32,526</u>	<u>938</u>	2.89%
<b>Total interest-bearing liabilities</b>	509,102	<u>\$ 6,627</u>	1.30%	346,067	<u>\$ 7,278</u>	2.11%
Non-interest bearing demand deposits	153,148			131,744		
Other liabilities	6,859			5,727		
Shareholders' equity	<u>83,400</u>			<u>58,251</u>		
<b>Total average liabilities and shareholder's equity</b>	<u>\$ 752,509</u>			<u>\$ 541,789</u>		
Interest income and rate earned on average earning assets		\$ 42,316	<u>6.30%</u>		\$ 32,539	<u>6.61%</u>
Interest expense and interest cost related to average interest-bearing liabilities		<u>6,627</u>	<u>1.30%</u>		<u>7,278</u>	<u>2.11%</u>
<b>Net interest income and net interest margin (4)</b>		<u>\$ 35,689</u>	<u>5.31%</u>		<u>\$ 25,261</u>	<u>5.13%</u>

(1) Calculated on a fully tax equivalent basis, which includes Federal tax benefits relating to income earned on municipal bonds totaling \$1,575 and \$576 in 2009 and 2008, respectively.

(2) Loan interest income includes loan fees of \$544 in 2009 and \$720 in 2008.

(3) Average loans do not include nonaccrual loans.

(4) Net interest margin is computed by dividing net interest income by total average interest-earning assets.

Interest and fee income from loans increased \$4,289,000 or 16.7% in 2009 compared to 2008. Interest and fee income decreased \$2,117,000 or 7.6% in 2008 compared to 2007. The increase in 2009 is attributable to an increase in average total loans outstanding offset by a 69 basis point decrease in the yield on loans. The decrease in 2008 is attributable to a decrease in the yield of 131 basis points partially offset by a 9.9% increase in the level of average loans in 2008 compared to 2007. Average total loans for 2009 increased \$115,449,000 to \$482,458,000 compared to \$367,009,000 for 2008 and \$331,459,000 for 2007. The yield on loans for 2009 was 6.37% compared to 7.06% and 8.37% for 2008 and 2007, respectively.

Interest income from total investments, (total investments include investment securities, Federal funds sold, interest-bearing deposits in other banks, and other securities) not on a fully tax equivalent basis, increased \$4,600,000 or 74% in 2009 compared to 2008 primarily due to a \$73,493,000 increase in the average balance to \$199,425,000 in 2009 compared to \$125,932,000 in 2008, coupled with an increase in yield on investments of 82 basis points. In 2008, total investment income increased \$1,396,000 from 2007 primarily due to a 22.0% increase in the average balances of these investments and a 29 basis point increase in the yields earned. Average total investments for 2008 were \$125,932,000 compared to \$103,253,000, for 2007. The increase in the investment portfolio is due primarily to the acquisition of Service 1<sup>st</sup>.

In an effort to increase yields, without accepting unreasonable risk, a significant portion of the investment purchases have been in mortgage-backed securities (MBS) and collateralized mortgage obligations (CMOs). At December 31, 2009, we held \$117,225,000 or 59.4% of the total market value of the investment portfolio in MBS and CMOs with an average yield of 6.9%. We invest in Collateralized Mortgage Obligations (CMO) and Mortgage Backed Securities, (MBS) as part of the overall strategy to increase our net interest margin. CMOs and MBS by their nature react to changes in interest rates. In a normal declining rate environment, prepayments from MBS and CMOs would be expected to increase and the expected life of the investment would be expected to shorten. Conversely, if interest rates increase, prepayments normally would be expected to decline and

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

## RESULTS OF OPERATIONS (continued)

### **Interest Income and Expense (continued)**

the average life of the MBS and CMOs would be expected to extend. However, in the current economic environment, prepayments may not behave according to historical norms. Premium amortization and discount accretion of these investments affects our net interest income. Our management monitors the prepayment speed of these investments and adjusts premium amortization and discount accretion based on several factors. These factors include the type of investment, the investment structure, interest rates, interest rates on new mortgage loans, expectation of interest rate changes, current economic conditions, the level of principal remaining on the bond, the bond coupon rate, the bond origination date, and volume of available bonds in market. The calculation of premium amortization and discount accretion is by nature inexact, and represents management's best estimate of principal pay downs inherent in the total investment portfolio.

The net of tax effect value of the change in market value of the available-for-sale investment portfolio was a loss of \$1,455,000 and is reflected in the Company's equity. At December 31, 2009, the average life of the investment portfolio was 8.1 years and the market value reflected a pre-tax loss of \$2,425,000. Management reviews market value declines on individual investment securities to determine whether they represent an other-than-temporary impairment (OTTI) and recorded a \$300,000 OTTI loss as of December 31, 2009. Future deterioration in the market values of our investment securities may require the Company to recognize additional OTTI losses.

A component of the Company's strategic plan has been to use its investment portfolio to offset, in part, its interest rate risk relating to variable rate loans. At December 31, 2009, an immediate rate increase of 200 basis points would result in an estimated decrease in the market value of the investment portfolio by approximately \$18,173,000. Conversely, with an immediate rate decrease of 200 basis points, the estimated increase in the market value of the investment portfolio is \$14,356,000. The modeling environment assumes management would take no action during an immediate shock of 200 basis points. The likelihood of immediate changes of 200 basis points is contrary to expectation, as evidenced by the changes in interest rates in the past two years, which were in 25, 50 and 75 basis point increments. However, the Company uses those increments to measure its interest rate risk in accordance with regulatory requirements and to measure the possible future risk in the investment portfolio. For further discussion of the Company's market risk, refer to Quantitative and Qualitative Disclosures about Market Risk.

Management's review of all investments before purchase includes an analysis of how the security will perform under several interest rate scenarios to monitor whether investments are consistent with our investment policy. The policy addresses issues of average life, duration, and concentration guidelines, prohibited investments, impairment, and prohibited practices.

Total interest income in 2009 increased \$8,889,000, to \$40,734,000 compared to \$31,845,000 in 2008 and \$32,566,000 in 2007. The increase in 2009 was due to the 36.5% increase in the average balance of interest-earning assets partially offset by the 31 basis point decrease in the yield on those assets. The yield on interest-earning assets decreased to 6.30% for the year ended December 31, 2009 from 6.61% and 7.59% for the years ended December 31, 2008 and 2007, respectively. Average interest-earning assets increased to \$671,906,000 for the year ended December 31, 2009 compared to \$492,414,000 and \$477,321,000 for the years ended December 31, 2008 and 2007, respectively. The \$179,492,000 increase in average earning assets in 2009 can be attributed to the Service 1<sup>st</sup> acquisition.

Interest expense on deposits in 2009 decreased \$473,000 or 7.5% to \$5,867,000 compared to \$6,340,000 in 2008 and \$7,894,000 in 2007. The decrease in interest expense in 2009 compared to 2008 was primarily due to the repricing of interest-bearing deposits which decreased 81 basis points to 1.22% in 2009 from 2.03% in 2008 as a result of the decreases in the Federal funds interest rate. This decrease was partially offset by a \$165,574,000 or 52.8% increase in average interest-bearing deposits. The decrease in interest expense in 2008 compared to 2007 was due to repricing of interest-bearing deposits, which decreased 76 basis points to 2.03% in 2008 from 2.79% in 2007, as a result of the decreases in the Federal funds interest rate. Average interest-bearing deposits were \$479,115,000 for 2009 compared to \$313,541,000 and 282,539,000 for 2008 and 2007, respectively. The increases in average interest-bearing deposits in 2009 and 2008 were the result of our own organic growth and the acquisition of Service 1<sup>st</sup> in November 2008.

Average other borrowings decreased to \$29,987,000 with an effective rate of 2.53% for 2009 compared to \$32,526,000 with an effective rate of 2.89% for 2008. In 2007, the average other borrowings were \$2,759,000 with an effective rate of 5.94%. Included in other borrowings are the junior subordinated deferrable interest debentures acquired from Service 1<sup>st</sup>, advances on lines of credit and advances from the Federal Home Loan Bank (FHLB). The FHLB advances are fixed rate short-term and long term borrowings. Advances were utilized as part of a leveraged strategy in the first quarter of 2008 to purchase investment securities. The effective rate of the FHLB advances was 3.08% for 2009 and 2008 compared to 4.87% for 2007. Other borrowings in 2007 included a loan from a major bank, which we paid in full during 2007.

The cost of all of our interest-bearing liabilities decreased 81 basis points to 1.30% for 2009 compared to 2.11% for 2008 and 2.82% for 2007, while the cost of total deposits decreased to 0.93% for the year ended December 31, 2009 compared to 1.42% and 1.89% for the years ended December 31, 2008 and 2007, respectively. Average demand deposits increased 16.3% to \$153,148,000 in 2009 compared to \$131,744,000 for 2008 and \$135,152,000 for 2007. The ratio of non-interest demand deposits to total deposits decreased to 24.2% for 2009 compared to 29.6% and 32.4% for 2008 and 2007, respectively.

### **Net Interest Income before Provision for Credit Losses**

Net interest income before provision for credit losses for 2009 increased \$9,540,000 or 38.8% to \$34,107,000 compared to \$24,567,000 for 2008 and \$24,508,000 for 2007. The increase in 2009 was mainly due to a 36.5% increase in average total interest-earning assets along with an 18 basis point increase in our net interest margin partially offset by a 47.1% increase in interest-bearing liabilities. The slight increase in net interest income before provision for credit losses in 2008 compared to 2007 was mainly due to an increase in average total interest-earning assets of 12.8% offset by an increase in interest-bearing liabilities of 21.3% and a decrease in the yield on total interest-earning assets of 98 basis points compared to 2007, while the cost of total interest-bearing liabilities decreased only 71 basis points. Average interest-earning assets were \$671,906,000 for the year ended December 31, 2009 with a net interest margin (NIM) of 5.31% compared to \$492,414,000 with a NIM of 5.13% in 2008, and \$436,564,000 with a NIM of 5.74% in 2007. For a discussion of the repricing of our assets and liabilities, refer to Quantitative and Qualitative Disclosure about Market Risk.

### **Provision for Credit Losses**

We provide for probable credit losses by a charge to operating income based upon the composition of the loan portfolio, delinquency levels, losses and nonperforming assets, economic and environmental conditions and other factors which, in management's judgment, deserve recognition in estimating credit losses. Loans are charged off when they are considered uncollectible or of such little value that continuance as an active earning bank asset is not warranted.

The establishment of an adequate credit allowance is based on both an accurate risk rating system and loan portfolio management tools. The Board has established initial responsibility for the accuracy of credit risk grades with the individual credit officer. The grading is then submitted to the Chief Credit Administrator (CCA), who reviews the grades for accuracy and gives final approval. The CCA is not involved in loan originations. The risk grading and reserve allocation is analyzed quarterly by the CCA and the Board and at least annually by a third party credit reviewer and by various regulatory agencies.

Quarterly, the CCA sets the specific reserve for all adversely risk-graded credits. This process includes the utilization of loan delinquency reports, classified asset reports, and portfolio concentration reports to assist in accurately assessing credit risk and establishing appropriate reserves. Reserves are also allocated to credits that are not impaired.

The allowance for credit losses is reviewed at least quarterly by the Board's Audit/Compliance Committee and by the Board of Directors. Reserves are allocated to loan portfolio categories using percentages which are based on both historical risk elements such as delinquencies and losses and predictive risk elements such as economic, competitive and environmental factors. We have adopted the specific reserve approach to allocate reserves to each impaired asset for the purpose of estimating potential loss exposure. Although the allowance for credit losses is allocated to various portfolio categories, it is general in nature and available for the loan portfolio in its entirety. Additions may be required based on the results of independent loan portfolio examinations, regulatory agency examinations, or our own internal review process. Additions are also required when, in management's judgment, the allowance does not properly reflect the portfolio's potential loss exposure.

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

## RESULTS OF OPERATIONS (continued)

### Provision for Credit Losses (continued)

The allocation of the allowance for credit losses is set forth below:

<u>Loan Type (Dollars in thousands)</u>	<u>December 31, 2009</u>	<u>% of Total Loans</u>	<u>December 31, 2008</u>	<u>% of Total Loans</u>
Commercial and industrial	\$ 2,861	24.7%	\$ 1,777	26.7%
Agricultural land and production	708	7.8%	235	6.7%
Real estate	3,813	49.4%	2,570	46.9%
Real estate - construction and other land loans	836	7.9%	820	9.6%
Equity loans and lines of credit	334	7.8%	64	6.8%
Consumer and installment	423	2.3%	593	3.1%
Other	48	0.1%	64	0.2%
Unallocated reserves	<u>1,177</u>		<u>1,100</u>	
Total allowance for credit losses	<u>\$ 10,200</u>		<u>\$ 7,223</u>	

The unallocated reserves as of December 31, 2009 are principally due to qualitative and quantitative factors (Q factors). The Q factor reserve was increased at year end 2008 due to the unknown level of loss exposure found in the acquired Service 1<sup>st</sup> portfolio. As we approach a year of experience, the allocation by loan type is better defined, thereby resulting in increased reserve levels by type. Q factors include reserves held for the effects of lending policies, economic trends, and portfolio trends along with other dynamics which may cause additional stress to the portfolio.

Managing problem credits identified through our risk evaluation methodology includes developing a business strategy with the customer to mitigate our potential losses. Management continues to monitor these credits with a view to identifying as early as possible when, and to what extent, additional provisions may be necessary.

The provisions for credit losses in 2009, 2008 and 2007 were \$10,514,000, \$1,290,000, and \$480,000, respectively. These provisions are primarily the result of our assessment of the overall adequacy of the allowance for credit losses considering a number of factors as discussed in the "Allowance for Credit Losses" section below. Nonperforming loans were \$18,959,000 and \$15,750,000 at December 31, 2009 and 2008, respectively. Nonperforming loans as a percentage of total loans were 4.13% at December 31, 2009 compared to 3.25% at December 31, 2008. Nonperforming loans acquired from Service 1<sup>st</sup> represented \$7,410,000 of the total balance at December 31, 2009. Other real estate owned at December 31, 2009 was \$2,832,000 net of a valuation allowance of \$356,000. The Company did not have any other real estate owned at December 31, 2008.

For 2009, 2008, and 2007, we had a net charge off ratio to average loans of 1.56%, 0.20% and 0.12%, respectively.

We believe the significant economic downturn witnessed during 2008 and that has continued throughout 2009 has had a considerable impact on the ability of certain borrowers to satisfy their obligations, resulting in loan downgrades and corresponding increases in credit loss provisions. Additionally, we estimate the impact certain economic factors will have on various credits within the portfolio. Negative economic trends witnessed during 2008 and 2009 contributed substantially to increases in the required allowance to cover potential losses in the loan portfolio, resulting in year-over-year increases in credit loss provisions.

Losses in the commercial and industrial and real estate segments of the loan portfolio during 2009 compared to 2008 increased significantly, contributing to the additional provisions we made to the allowance for credit losses. Although the majority of losses within these segments of the portfolio were the result of several large write-downs, we witnessed an increase in the number and total dollar volume of past due loans within the commercial and industrial and real estate segments. Past due loans, not including non accrual loans, in these segments totaled \$3,522,000 at December 31, 2009 compared to \$895,000 at December 31, 2008. Non-accruing balances remain elevated relative to historical periods, also contributing to increased credit loss provisions. Continued increases in the level of charge-offs and the number and dollar volume of past due and nonperforming loans may result in further provisions to the allowance for credit losses.

We anticipate weakness in economic conditions on national, state and local levels to continue. Continued economic pressures may negatively impact the financial condition of borrowers to whom the Company has extended credit and as a result we may be required to make further significant provisions to the allowance for credit losses in the future. We have been and will continue to be proactive in looking for signs of deterioration within the loan portfolio in an effort to manage credit quality and work with borrowers where possible to mitigate any further losses.

As of December 31, 2009, we believe, based on all current and available information, the allowance for credit losses is adequate to absorb current estimable losses within the loan portfolio. However, no assurance can be given that we may not sustain charge-offs which are in excess of the allowance in any given period. Refer to "Allowance for Credit Losses" below for further information.

### Net Interest Income After Provision for Credit Losses

Net interest income, after the provision for credit losses of \$10,514,000 in 2009, \$1,290,000 in 2008, and \$480,000 in 2007, was \$23,593,000 for 2009 compared to \$23,277,000 and \$24,028,000 for 2008 and 2007, respectively.

### Non-Interest Income

Non-interest income is comprised of customer service charges, gains on sales and calls of investment securities, income from appreciation in cash surrender value of bank owned life insurance, loan placement fees, Federal Home Loan Bank dividends, and other income. Non-interest income was \$5,850,000 in 2009 compared to \$5,190,000 and \$4,518,000 in 2008 and 2007, respectively. The \$660,000 or 12.7% increase in non-interest income in 2009 compared to 2008 was due to increases in gains on sales and calls of investment securities, customer service charges, appreciation in cash surrender value of bank owned life insurance, loan placement fees, and other income. The \$672,000 increase in non-interest income comparing 2008 to 2007 was due to increases in customer service charges, gains on sales and calls of investment securities and other income.

Customer service charges increased \$159,000 to \$3,509,000 in 2009 compared to \$3,350,000 in 2008 and \$2,859,000 in 2007. The increase in both years is mainly due to an increase in the activity level as the average number of transaction accounts has increased organically and as a result of the Service 1<sup>st</sup> acquisition, as have the fees generated by the overdraft protection program.

During the year ended December 31, 2009, we realized net gains on sales and calls of investment securities of \$466,000, comprised of \$766,000 in net gains from sales and calls of securities offset by a \$300,000 other-than-temporary impairment write down of one investment security. See Footnote 4 to the audited Consolidated Financial Statements for more detail. Net gains from sales and calls of securities for the same period in 2008 totaled \$165,000 and \$63,000 in 2007. The Company marked the investment securities portfolio, acquired from Service 1<sup>st</sup>, to market at the acquisition date, and securities subsequently called at par value contributed \$579,000 of the gain and \$187,000 was a result of the sale of investment securities.

Income from the appreciation in cash surrender value of bank owned life insurance (BOLI) totaled \$391,000 in 2009 compared to \$268,000 and \$226,000 in 2008 and 2007, respectively. The \$123,000 or 45.9% increase comparing the year ended December 31, 2009 with the same period in 2008 is due to an increase in the average balance in this portfolio as a result of the Service 1<sup>st</sup> acquisition. The Bank's salary continuation and deferred compensation plans and the related BOLI are used as a retention tool for directors and key executives of the Bank.

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

## RESULTS OF OPERATIONS (continued)

### Non-Interest Income (continued)

We earn loan placement fees from the brokerage of single-family residential mortgage loans provided for the convenience of our customers. Loan placement fees increased \$120,000 in 2009 to \$231,000 compared to \$111,000 in 2008 and \$185,000 in 2007. In 2009, refinancing and new mortgage activity increased due to the historically low mortgage rates, first time home buyer tax incentives and a decline in housing values. The decrease in 2008 compared to 2007 occurred due to a slowdown in the housing market in California and the tightening of the credit market resulting in fewer refinancing opportunities.

The Bank holds stock from the Federal Home Loan Bank in relationship with its borrowing capacity and generally receives quarterly dividends. As of December 31, 2009 and 2008, we held \$3,140,000 in FHLB stock. Dividends in 2009 decreased to \$7,000 compared to \$118,000 in 2008 and \$102,000 in 2007.

Other income increased to \$1,246,000 in 2009 compared to \$1,178,000 and \$1,083,000 in 2008 and 2007, respectively. The \$68,000 increase in 2009 compared to 2008 was due to an increase in electronic funds transfer fee income. The increase comparing 2008 to 2007 was primarily due to increases in merchant fees from bankcards and electronic funds transfer fee income.

### Non-Interest Expenses

Salaries and employee benefits, occupancy, regulatory assessments, data processing expenses, and professional services are the major categories of non-interest expenses. Non-interest expenses increased \$6,555,000 to \$27,531,000 in 2009 compared to \$20,976,000 in 2008, which was an increase of \$1,877,000 in 2008 compared to \$19,099,000 in 2007.

Our efficiency ratio, measured as the percentage of non-interest expenses (exclusive of amortization of core deposit intangibles and foreclosure expenses) to net interest income before provision for credit losses plus non-interest income (exclusive of realized gains on sale and calls of investments) was 67.3% for 2009 compared to 70.1% for 2008 and 65.2% for 2007. Our efficiency ratio decreased in 2009 compared to 2008 due to a 35.3% increase in net interest income plus non-interest income. The increase in the ratio comparing 2008 to 2007 was due to an increase in operating expenses.

Salaries and employee benefits increased \$2,348,000 or 20.3% to \$13,926,000 in 2009 compared to \$11,578,000 in 2008 and \$10,829,000 in 2007. The increase in 2009 compared to 2008 can be attributed to the addition of personnel in connection with the Service 1<sup>st</sup> acquisition and the opening of the new Merced office along with normal cost increases for salaries and employee benefits. The increase in 2008 compared to 2007 is primarily due to normal cost increases for salaries and benefits, and a slight increase in personnel covering the period after the Service 1<sup>st</sup> acquisition on November 12, 2008.

We have three share based compensation plans under which compensation expense is recognized based on the estimated fair value of the awards at the date of the grant.

The Company bases the fair value of the options previously granted on the date of grant using a Black-Scholes Merton option pricing model that uses assumptions based on expected option life, the level of estimated forfeitures, expected stock volatility and the risk-free interest rate. Stock volatility is based on the historical volatility of the Company's stock. The risk-free rate is based on the U.S. Treasury yield curve and the expected term of the options. The expected term of the options represents the period that the Company's options are expected to be outstanding.

For the years ended December 31, 2009, 2008 and 2007, the compensation cost recognized for stock option compensation was \$284,000, \$100,000 and \$221,000, respectively.

As of December 31, 2009, there was \$452,000 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the 2000 and 2005 Plans. The cost is expected to be recognized over a weighted average period of 2.2 years. See Notes 1 and 13 to the audited Consolidated Financial Statements for more detail.

In 2009, options to purchase 13,500 shares of the Company's common stock were granted at exercise prices of between \$5.06 and \$6.40 from the 2005 Plan. All options were granted with an exercise price equal to the market value on the grant date.

In October 2007, the Board of Directors of the Company approved the cancellation of options to purchase 15,000 shares of the Company's common stock granted on May 1, 2006 and options to purchase 78,900 shares of common stock granted on April 23, 2007. The Board granted new options to the directors, senior managers and other employees in the same numbers and to the same employees who were holders of the cancelled options. The grant date of the new options was October 17, 2007 and the options were granted with an exercise price equal to the fair market value on the grant date of \$12.00 per share. As a result of this modification the Company recognized an additional \$29,000 in incremental stock based compensation expense in 2007.

In December 2008, the Company cancelled options to purchase 90,550 shares of common stock granted on October 17, 2007 and options to purchase 15,000 shares of common stock granted on October 1, 2007, and on December 17, 2008 the Company granted new options to purchase 105,550 shares of common stock to the directors, senior managers and other employees. The modification affected 57 employees and eight directors and the total incremental compensation cost recognized for the modification in 2008 was \$38,000. The grant date of the new options was December 17, 2008 and the options were granted with an exercise price equal to the fair market value on the grant date of \$6.70 per share. In addition, the Board of Directors of the Company granted options to purchase 15,000 shares of common stock during 2008 at the fair market value on the grant date.

The Board considered the general decline in stocks of financial institutions as a whole in reaching their decision. The cancellation of previously issued options reflects the Board's desire to ensure that options continue to provide proper incentive to key personnel.

Occupancy and equipment expense increased \$922,000 or 31.9% to \$3,812,000 in 2009 compared to \$2,890,000 in 2008 and \$2,618,000 in 2007. The increase in both 2009 and 2008 was primarily due to the addition of three new branch locations in Tracy, Stockton and Lodi California as a result of the Service 1<sup>st</sup> acquisition in the fourth quarter of 2008, the new Merced office opened in 2009 and the relocation of our Herndon and Fowler branch in Clovis, California during the second quarter of 2008 from an in-store location to a larger traditional branch facility.

Regulatory assessments increased \$1,274,000 or 386.1% to \$1,604,000 in 2009 compared to \$330,000 and \$109,000 in 2008 and 2007, respectively. The increase in 2009 was due to the increase in FDIC insurance premiums as a result of an increase in deposit balances due to the Service 1<sup>st</sup> acquisition, an increase in the assessment rates recently enacted by the FDIC, and an FDIC imposed Special Assessment of \$343,000 that was effective during the second quarter of 2009. With our three year prepayment of FDIC premiums in the fourth quarter of 2009, we expect that these assessments will remain at historically high levels for the foreseeable future. The increase in 2008 compared to 2007 is due mainly to an increase in FDIC assessment rates.

Data processing expenses were \$1,316,000 in 2009 compared to \$848,000 in 2008 and \$847,000 in 2007. The \$468,000 or 55.2% increase in 2009 was due to the Service 1<sup>st</sup> acquisition and the addition of new branch locations.

Other non-interest expenses increased \$674,000 or 15.2% to \$5,114,000 in 2009 compared to \$4,440,000 in 2008 and \$3,833,000 in 2007.

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

## RESULTS OF OPERATIONS (continued)

### Non-Interest Expenses (continued)

The following table describes significant components of other non-interest expense as a percentage of average assets.

For the years ended December 31, (Dollars in thousands)	Other Expense 2009	% Avg. Assets	Other Expense 2008	% Avg. Assets	Other Expense 2007	% Avg. Assets
Amortization of core deposit intangibles	\$ 414	0.06%	\$ 231	0.04%	\$ 214	0.04%
Consulting	454	0.06%	192	0.04%	197	0.04%
ATM/debit card expenses	419	0.06%	308	0.06%	288	0.06%
Legal fees	330	0.04%	141	0.03%	112	0.02%
Telephone	272	0.04%	205	0.04%	189	0.04%
Stationery and supplies	271	0.04%	226	0.04%	222	0.05%
License and maintenance contracts	251	0.03%	170	0.03%	59	0.01%
Postage	233	0.03%	178	0.03%	178	0.04%
Director fees and related expenses	205	0.03%	173	0.03%	173	0.04%
Amortization of software	194	0.03%	101	0.02%	79	0.02%
General insurance	144	0.02%	136	0.03%	131	0.03%
Appraisal fees	125	0.02%	4	0.00%	1	0.00%
Donations	99	0.01%	90	0.02%	107	0.02%
Education and training	85	0.01%	96	0.02%	87	0.02%
Operating losses	47	0.01%	90	0.02%	58	0.01%
Merger expenses	2	0.00%	447	0.08%	-	0.00%
Other	<u>1,569</u>	<u>0.21%</u>	<u>1,652</u>	<u>0.30%</u>	<u>1,738</u>	<u>0.36%</u>
Total other non-interest expense	<u>\$ 5,114</u>	<u>0.68%</u>	<u>\$ 4,440</u>	<u>0.82%</u>	<u>\$ 3,833</u>	<u>0.80%</u>

In 2009, the \$183,000 increase in amortization of core deposit intangibles (CDI) is due to the CDI associated with the acquisition of Service 1<sup>st</sup>. The \$262,000 increase in consulting expenses was related to assistance with renegotiating our core processor contracts. The increases of \$189,000 in legal expenses and \$120,000 increase in appraisal fees is primarily due to issues related to nonperforming assets and other loan related expenses. The increase in various other expenses was principally due to the addition of the Service 1<sup>st</sup> offices and the new Oakhurst and Merced offices. The increase in 2008 compared to 2007 related primarily to \$447,000 of Service 1<sup>st</sup> acquisition related expenses, and \$40,000 of branch relocation expenses incurred in 2008.

### Provision for Income Taxes

Our effective income tax rate was (35.3%) for 2009 compared to 31.4% for 2008 and 33.5% for 2007. The Company reported an income tax benefit of \$676,000 for the year ended December 31, 2009, compared to a provision totaling \$2,352,000 and \$3,167,000 for the years ended December 31, 2008 and 2007, respectively. The decrease in the effective tax rate for the year ended December 31, 2009 compared to 2008 is due primarily to increases, as a percentage of pretax income, in the Federal tax deduction for tax free municipal bonds, solar tax credits, the state tax deduction for loans in designated enterprise zones in California, and state hiring tax credits.

### Preferred Stock Dividends and Accretion

On January 30, 2009, the Company entered into a Letter Agreement with the United States Department of the Treasury (Treasury) under the Capital Purchase Program, and issued and sold 7,000 shares of the Company's Series A Fixed Rate Cumulative Perpetual Preferred Stock (Preferred Stock) and a Warrant to purchase 158,133 shares at \$6.64 per share of the Company's common stock, no par value, for an aggregate purchase price of \$7,000,000 in cash. According to the agreement, if we received aggregate gross cash proceeds of not less than \$7 million from a Qualified Equity Offering (QEO) on or prior to December 31, 2009, the number of shares issuable under the Warrant can be reduced by one half. On December 23, 2009, we received \$8,000,000 in gross proceeds from a QEO and subsequently the Treasury agreed to reduce the number of common shares issuable under the Warrant to 79,067. We accrued preferred stock dividends to the Treasury and accretion of the issuance discount in the amount of \$365,000 during the year ended December 31, 2009.

## FINANCIAL CONDITION

### Summary of Changes in Consolidated Balance Sheets

December 31, 2009 compared to December 31, 2008

As of December 31, 2009, total assets were \$765,488,000, an increase of 1.7%, or \$12,775,000, compared to \$752,713,000 as of December 31, 2008. Total gross loans decreased 5.2%, or \$25,031,000, to \$459,207,000 as of December 31, 2009 compared to \$484,238,000 as of December 31, 2008. Total investment portfolio increased 1.7% to \$197,598,000. Total deposits increased slightly by 0.8%, or \$5,109,000, to \$640,167,000 as of December 31, 2009 compared to \$635,058,000 as of December 31, 2008. Shareholders' equity increased 21.0%, or \$15,848,000, to \$91,223,000 as of December 31, 2009 compared to \$75,375,000 as of December 31, 2008.

### Fair Value

The Company measures the fair values of its financial instruments utilizing a hierarchical disclosure framework associated with the level of observable pricing scenarios utilized in measuring financial instruments at fair value. The degree of judgment utilized in measuring the fair value of financial instruments generally correlates to the level of the observable pricing scenario. Financial instruments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of observable pricing and a lesser degree of judgment utilized in measuring fair value. Conversely, financial instruments rarely traded or not quoted will generally have little or no observable pricing and a higher degree of judgment utilized in measuring fair value. Observable pricing scenarios are impacted by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established and the characteristics specific to the transaction.

See Note 3 of the audited Consolidated Financial Statements for additional information about the level of pricing transparency associated with financial instruments carried at fair value.



# Management's Discussion and Analysis

## of Financial Condition and Results of Operations

### FINANCIAL CONDITION (continued)

#### Investments

Our investment portfolio consists primarily of agency securities, mortgage backed securities, municipal securities, collateralized mortgage obligations, corporate debt securities, and overnight investments in the Federal funds market and are classified at the date of acquisition as available for sale or held to maturity. As of December 31, 2009, investment securities with a fair value of \$126,585,000, or 64.2% of our investment securities portfolio, were held as collateral for public funds, short and long-term borrowings, treasury, tax, and for other purposes. Our investment policies are established by the Board of Directors and implemented by our Investment/Asset Liability Committee. They are designed primarily to provide and maintain liquidity, to enable us to meet our pledging requirements for public money and borrowing arrangements, to generate a favorable return on investments without incurring undue interest rate and credit risk, and to complement our lending activities.

The level of our investment portfolio is generally considered higher than our peers due primarily to a comparatively low loan to deposit ratio. Our loan to deposit ratio at December 31, 2009 was 71.7% compared to 76.3% at December 31, 2008. The loan to deposit ratio of our peers was 88.0% at September 30, 2009. The total investment portfolio, including Federal funds sold, increased 1.7% or \$3,383,000 to \$197,598,000 at December 31, 2009 from \$194,215,000 at December 31, 2008 primarily due to purchases of securities. The market value of the portfolio reflected an unrealized loss of \$2,425,000 at December 31, 2009 compared to a \$313,000 gain at December 31, 2008.

We periodically evaluate each investment security for other-than-temporary impairment, relying primarily on industry analyst reports, observation of market conditions and interest rate fluctuations.

As of December 31, 2009, we performed an analysis of the investment portfolio to determine whether any of the investments held in the portfolio had an other-than-temporary impairment (OTTI). We evaluated all available-for-sale investment securities with an unrealized loss at December 31, 2009 and identified those that had an unrealized loss for at least a consecutive 12 month period, which had an unrealized loss at December 31, 2009 greater than 10% of the recorded book value on that date, or which had an unrealized loss of more than \$10,000. In addition, we reviewed all private label residential mortgage backed securities (PLRMBS) at December 31, 2009.

For those bonds that met the evaluation criteria we obtained and reviewed the most recently published national credit ratings for those bonds. For those bonds that were municipal debt securities with an investment grade rating by the rating agencies, we also evaluated the financial condition of the municipality and any applicable municipal bond insurance provider and concluded that no credit related impairment existed based on the rating. Our evaluation also includes estimating projected cash flows that the Company is likely to collect based on an assessment of all available information about the applicable security on an individual basis, the structure of the security, and certain assumptions, such as the remaining payment terms for the security, prepayment speeds, default rates, loss severity on the collateral supporting the security based on underlying loan-level borrower and loan characteristics, expected housing price changes, and interest rate assumptions, to determine whether the Company will recover the entire amortized cost basis of the security. In performing a detailed cash flow analysis, the Company identified the best estimate of the cash flows expected to be collected. If this estimate results in a present value of expected cash flows (discounted at the security's effective yield) that is less than the amortized cost basis of the security, an OTTI is considered to have occurred.

To assess whether it expects to recover the entire amortized cost basis of its PLRMBS, the Company performed a cash flow analysis for all of its PLRMBS as of December 31, 2009. In performing the cash flow analysis for each security, the Company uses a third-party model. The model considers borrower characteristics and the particular attributes of the loans underlying the Company's securities, in conjunction with assumptions about future changes in home prices and other assumptions, to project prepayments, default rates, and loss severities.

The month-by-month projections of future loan performance are allocated to the various security classes in each securitization structure in accordance with the structure's prescribed cash flow and loss allocation rules. When the credit enhancement for the senior securities in a securitization is derived from the presence of subordinated securities, losses are allocated first to the subordinated securities until their principal balance is reduced to zero. The projected cash flows are based on a number of assumptions and expectations, and the results of these models can vary significantly with changes in assumptions and expectations. The scenario of cash flows determined based on the model approach described above reflects a best-estimate scenario.

At each quarter end, the Company compares the present value of the cash flows expected to be collected on its PLRMBS to the amortized cost basis of the securities to determine whether a credit loss exists.

The unrealized losses associated with PLRMBS are primarily driven by higher projected collateral losses, wider credit spreads and changes in interest rates. The Company assesses for credit impairment using a discounted cash flow model. The key assumptions include home price depreciation, default rates, severities, discount rates and prepayment rates. We estimate losses to a security by forecasting the underlying mortgage loans in each transaction. The forecasted loan performance is used to project cash flows to the various tranches in the structure. Based upon management's assessment of the expected credit losses of the security given the performance of the underlying collateral compared with our credit enhancement (which occurs as a result of credit loss protection provided by subordinated tranches), we expect to recover the entire amortized cost basis of these securities.

Based on the analyses performed, the expected discounted cash flows were greater than the recorded book value of the individual securities. We recorded an OTTI loss of \$300,000 for one security that was sold at a loss subsequent to December 31, 2009, and recorded an unrealized loss in other comprehensive income for the other securities.

At December 31, 2009, the Company had a total of 46 private residential CMO holdings with a remaining principal balance of \$36,280,000 and a net unrealized loss of approximately \$5,010,000. 19 of these securities account for \$5,413,000 of the unrealized loss at December 31, 2009 offset by 27 of these securities with gains totaling \$403,000. 12 of these PLRMBS holdings with a remaining principal balance of \$24,230,000 had credit ratings below investment grade. The Company continues to perform extensive analyses on these securities as well as all whole loan CMOs. These investment securities continue to demonstrate cash flows and credit support as expected and the expected cash flows of the security discounted at the security's implicit interest rate are greater than the book value of the security, therefore we do not consider these to be other than temporarily impaired.

See Note 4 to the audited Consolidated Financial Statements for carrying values and estimated fair values of our investment securities portfolio.

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

### FINANCIAL CONDITION (continued)

#### Loans

Total gross loans have decreased to \$459,207,000 as of December 31, 2009 compared to \$484,238,000 as of December 31, 2008.

The following table sets forth information concerning the composition of our loan portfolio as of December 31, 2009 and 2008:

Loan Type (Dollars in thousands)	December 31, 2009	% of Total loans	December 31, 2008	% of Total loans
<b>Commercial:</b>				
Commercial and industrial	\$ 113,535	24.7%	\$ 129,563	26.7%
Agricultural land and production	<u>35,796</u>	7.8%	<u>32,408</u>	6.7%
Total commercial	149,331	32.5%	161,971	33.4%
<b>Real estate:</b>				
Owner occupied	106,606	23.2%	113,414	23.4%
Real estate-construction and other land loans	36,169	7.9%	46,558	9.6%
Commercial real estate	71,977	15.7%	64,358	13.3%
Other	<u>48,187</u>	10.5%	<u>49,425</u>	10.2%
Total real estate	262,939	57.3%	273,755	56.5%
<b>Consumer:</b>				
Equity loans and lines of credit	36,110	7.8%	32,874	6.8%
Consumer and installment	10,545	2.3%	14,993	3.1%
Other	<u>674</u>	0.1%	<u>863</u>	0.2%
Total consumer	47,329	10.2%	48,730	10.1%
Deferred loan fees, net	<u>(392)</u>		<u>(218)</u>	
Total gross loans	459,207	100.0%	484,238	100.0%
Allowance for credit losses	<u>(10,200)</u>		<u>(7,223)</u>	
Total loans	<u>\$ 449,007</u>		<u>\$ 477,015</u>	

At December 31, 2009, in management's judgment, a concentration of loans existed in commercial loans and real-estate-related loans, representing approximately 97.6% of total loans of which 32.5% were commercial and 65.1% were real-estate-related. This level of concentration is consistent with the 96.8% at December 31, 2008. Although we believe the loans within this concentration have no more than the normal risk of collectibility, a substantial further decline in the performance of the economy in general or a further decline in real estate values in our primary market areas, in particular, could have an adverse impact on collectibility, increase the level of real estate-related nonperforming loans, or have other adverse effects which alone or in the aggregate could have a material adverse effect on our business, financial condition, results of operations and cash flows. The Company was not involved in any sub-prime mortgage lending activities at December 31, 2009 or December 31, 2008.

We believe that our commercial real estate loan underwriting policies and practices result in prudent extensions of credit, but recognize that our lending activities result in relatively high reported commercial real estate lending levels. Commercial real estate loans include certain loans which represent low to moderate risk and certain loans with higher risks.

The Board of Directors reviews and approves concentration limits and exceptions to limitations of concentrations are reported to the Board of Directors at least quarterly.

#### Nonperforming Assets

Nonperforming assets consist of nonperforming loans, other real estate owned (OREO), and repossessed assets. Nonperforming loans are those loans which have (i) been placed on nonaccrual status, (ii) been subject to troubled debt restructuring, (iii) been classified as doubtful under our asset classification system, or (iv) become contractually past due 90 days or more with respect to principal or interest and have not been restructured or otherwise placed on nonaccrual status. A loan is classified as nonaccrual when 1) it is maintained on a cash basis because of deterioration in the financial condition of the borrower, 2) payment in full of principal or interest under the original contractual terms is not expected, or 3) principal or interest has been in default for a period of 90 days or more unless the asset is both well secured and in the process of collection.

At December 31, 2009, nonperforming assets totaled \$21,838,000 compared to \$15,750,000 at December 31, 2008. In 2009, nonperforming assets included nonaccrual loans totaling \$18,959,000, OREO of \$2,832,000, and repossessed assets of \$47,000. Nonperforming assets in 2008 consisted of nonaccrual loans. At December 31, 2009, we had seven loans considered troubled debt restructurings totaling \$4,568,000, which are included in nonaccrual loans. We had two restructured loans totaling \$1,703,000, and no OREO or repossessed assets at December 31, 2008.

A summary of nonaccrual, restructured, and past due loans at December 31, 2009 and 2008 is set forth below. The Company had no loans past due more than 90 days and still accruing interest at December 31, 2009 or 2008. Management is not aware of any potential problem loans, which were current and accruing at December 31, 2009, where serious doubt exists as to the ability of the borrower to comply with the present repayment terms. Management can give no assurance that nonaccrual and other nonperforming loans will not increase in the future.

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

## FINANCIAL CONDITION (continued)

### Nonperforming Assets (continued)

#### Composition of Nonaccrual, Past Due and Restructured Loans

(Dollars in thousands)	December 31, 2009	December 31, 2008
Nonaccrual Loans		
Commercial and industrial	\$ 3,386	\$ 1,125
Real Estate	3,183	5,159
Real estate construction and land development	7,474	7,635
Consumer	348	80
Other	-	48
Restructured loans (non-accruing)		
Commercial and industrial	28	-
Real Estate	4,540	1,108
Real estate construction and land development	-	595
Total nonaccrual	<u>18,959</u>	<u>15,750</u>
Accruing loans past due 90 days or more	-	-
Total nonperforming loans	<u>\$ 18,959</u>	<u>\$ 15,750</u>
Nonperforming loans to total loans	4.13%	3.25%
Ratio of nonperforming loans to allowance for credit losses	185.87%	218.05%
Loans considered to be impaired	<u>\$ 18,959</u>	<u>\$ 15,750</u>
Related allowance for credit losses on impaired loans	<u>\$ 752</u>	<u>\$ 125</u>

We measure our impaired loans by using the fair value of the collateral if the loan is collateral dependent and the present value of the expected future cash flows discounted at the loan's effective interest rate if the loan is not collateral dependent. As of December 31, 2009 and 2008, we had impaired loans totaling \$18,959,000 and \$15,750,000, respectively. For collateral dependent loans secured by real estate, we obtain external appraisals which are updated at least annually to determine the fair value of the collateral, and we record an immediate charge off for the difference between the book value of the loan and the appraised value of collateral. We perform quarterly internal reviews on substandard loans. We place loans on nonaccrual status and classify them as impaired when it becomes probable that we will not receive interest and principal under the original contractual terms, or when loans are delinquent 90 days or more unless the loan is both well secured and in the process of collection. Management maintains certain loans that have been brought current by the borrower (less than 30 days delinquent) on nonaccrual status until such time as management has determined that the loans are likely to remain current in future periods. Foregone interest on nonaccrual loans totaled \$852,000 and \$371,000 for 2009 and 2008, respectively of which \$404,000 and \$139,000 was attributable to troubled debt restructurings, respectively.

The Bank was party to a lawsuit filed by Regent Hotel, LLC against First Bank (Lead Bank), as the lead bank in a loan participation, and East West Bank and Service 1<sup>st</sup> Bank, which was acquired by the Bank on November 13, 2008, which we were participating in the loan. In 2009, the Lead Bank purchased the Bank's participating interest in the Regent Hotel loan at a discount and indemnified the Bank against any further actions pursuant to the lawsuit. Included in the merger consideration paid by the Company to acquire Service 1<sup>st</sup> was \$3,500,000 which was placed into an escrow fund to protect the Company and the Bank from all losses and liabilities that related to the loan participation and/or the Regent Litigation. Consequent to the Lead Bank buying the Bank's position, the Bank collected \$1,046,000 from the escrow fund to cover the portion of the loan that was not recovered, accrued and unpaid interest and other costs. In accordance with the escrow agreement, until the litigation is completely satisfied the remaining \$2,454,000 is expected to remain in the escrow fund.

### Allowance for Credit Losses

We have established a methodology for the determination of the allowance for credit losses. The methodology is set forth in a formal policy and takes into consideration the need for an overall allowance for credit losses as well as specific allowances that are tied to individual loans. Our methodology for assessing the appropriateness of the allowance consists of several key elements, which include the formula allowance and a specific allowance for identified problem loans.

In originating loans, we recognize that losses will be experienced and that the risk of loss will vary with, among other things, the type of loan being made, the creditworthiness of the borrower over the term of the loan, general economic conditions and, in the case of a secured loan, the quality of the collateral securing the loan. The allowance is increased by provisions charged against earnings and reduced by net loan charge offs. Loans are charged off when they are deemed to be uncollectible, or partially charged off when portions of a loan are deemed to be uncollectible. Recoveries are recorded only when cash payments are received.

The allowance for credit losses is maintained to cover probable losses inherent in the loan portfolio. The responsibility for the review of our assets and the determination of the adequacy lies with management and our Audit Committee. They delegate the authority to the Chief Credit Administrator (CCA) to determine the loss reserve ratio for each type of asset and review, at least quarterly, the adequacy of the allowance based on an evaluation of the portfolio, past experience, prevailing market conditions, amount of government guarantees, concentration in loan types, and other relevant factors.

The allowance for credit losses is an estimate of the losses that may be sustained in our loan and lease portfolio. The allowance is based on principles of accounting: (1) ASC 310-10 which requires that losses be accrued when they are probable of occurring and can be reasonably estimated and (2) ASC 450-20 which requires that losses be accrued 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.

Credit Administration adheres to an internal asset review system and loss allowance methodology designed to provide for timely recognition of problem assets and adequate valuation allowances to cover expected asset losses. The Bank's asset monitoring process includes the use of asset classifications to segregate the assets, largely loans and real estate, into various risk categories. The Bank uses the various asset classifications as a means of measuring risk and determining the adequacy of valuation allowances by using a nine-grade system to classify assets. All credit facilities exceeding 90 days of delinquency require classification.

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

## FINANCIAL CONDITION (continued)

### Allowance for Credit Losses (continued)

The following table sets forth information regarding our allowance for credit losses at the dates and for the periods indicated:

(Dollars in thousands)	Years Ended December 31,	
	2009	2008
Balance, beginning of the year	\$ 7,223	\$ 3,887
Provision charged to operations	10,514	1,290
Losses charged to allowance	(7,926)	(851)
Recoveries	389	111
Allowance from acquisition of Service 1 <sup>st</sup>	-	2,786
Balance, end of year	<u>\$ 10,200</u>	<u>\$ 7,223</u>
Allowance for credit losses to total loans	2.22%	1.49%

As of December 31, 2009 the balance in the allowance for credit losses was \$10,200,000 compared to \$7,223,000 as of December 31, 2008. The increase was due to net charge offs during 2009 being less than the amount of the provision for credit losses. Net charge offs totaled \$7,537,000 while the provision for credit losses was \$10,514,000. The balance of commitments to extend credit on undisbursed construction and other loans and letters of credit was \$131,139,000 as of December 31, 2009 compared to \$160,450,000 as of December 31, 2008. Risks and uncertainties exist in all lending transactions, and our management and Directors' Loan Committee have established reserve levels based on economic uncertainties and other risks that exist as of each reporting period.

As of December 31, 2009 the allowance for credit losses was 2.22% of total gross loans compared to 1.49% as of December 31, 2008. During 2009 there were no major changes in loan concentrations that significantly affected the allowance for credit losses. The increase in 2009 is due to an increase in the level of charged off loans as well as increases in classified loans as a result of the economic downturn and deterioration of real estate appraised values. There have been no significant changes in estimation methods during the periods presented. Assumptions regarding the collateral value of various under performing loans may affect the level and allocation of the allowance for credit losses in future periods. The allowance may also be affected by trends in the amount of charge offs experienced or expected trends within different loan portfolios. Of the losses charged to the allowance in 2009 and 2008 of \$7,926,000 and \$851,000, the portion related to overdraft losses on transaction deposit accounts totaled \$126,000 and \$137,000, respectively.

Nonperforming loans totaled \$18,959,000 as of December 31, 2009, and \$15,750,000 as of December 31, 2008. The allowance for credit losses as a percentage of nonperforming loans was 53.8% and 45.9% as of December 31, 2009 and 2008, respectively. Management believes the allowance at December 31, 2009 is adequate based upon its ongoing analysis of the loan portfolio, historical loss trends and other factors. However, no assurance can be given that the Company may not sustain charge-offs which are in excess of the allowance in any given period.

### Goodwill and Intangible Assets

Business combinations involving the Bank's acquisition of the equity interests or net assets of another enterprise give rise to goodwill. Total goodwill at December 31, 2009 was \$23,577,000 consisting of \$14,643,000 and \$8,934,000 representing the excess of the cost of Service 1st Bank and Bank of Madera County, respectively, over the net of the amounts assigned to assets acquired and liabilities assumed in the transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Bank's ability to generate net earnings after the acquisitions 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 at least annually for impairment.

In conjunction with our annual review during the third quarter of 2009, we engaged an independent valuation specialist to test goodwill for impairment. Goodwill impairment testing is a two step process. The first step compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount exceeds the fair value, the second step of the goodwill impairment test is performed to measure the impairment loss, if any. If the fair value of the reporting unit exceeds the carrying value, then goodwill is not impaired and step two is unnecessary. Since the Company is considered to be one reporting unit, the fair value of the Company was compared to the carrying value. Based on the results of the testing performed, the fair value of the Company exceeded the carrying value so step two was not required and goodwill was not impaired. The fair value of the Company was determined based on an analysis of three different valuation methods including the analysis of discounted future cash flows, comparable whole bank transactions, and the Company's market capitalization plus a control premium.

Goodwill is also tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the Company below its carrying amount. No such events or circumstances arose during the fourth quarter of 2009, so goodwill was not required to be retested.

The intangible assets represent the estimated fair value of the core deposit relationships acquired in the acquisition of Service 1<sup>st</sup> Bank in 2008 of \$1,400,000 and the 2005 acquisition of Bank of Madera County of \$1,500,000 at December 31, 2009. Core deposit intangibles are being amortized using the straight-line method over an estimated life of seven years from the date of acquisition. The carrying value of intangible assets at December 31, 2009 was \$1,612,000, net of \$1,288,000 in accumulated amortization expense. The carrying value at December 31, 2008 was \$2,026,000, net of \$891,000 accumulated amortization expense. We evaluate the remaining useful lives quarterly to determine whether events or circumstances warrant a revision to the remaining periods of amortization. Based on the evaluation, no changes to the remaining useful lives was required. We performed its annual impairment test on core deposit intangibles in the third quarter of 2009 and determined no impairment was necessary. Amortization expense recognized for 2009, 2008, and 2007 was \$414,000, \$231,000, and \$214,000, respectively.

### Deposits and Borrowings

The Bank's deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to applicable legal limits. The Bank is also participating in the FDIC Transaction Account Guarantee Program (TAGP). Under that program, through June 30, 2010, all non-interest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Coverage under the TAGP is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules.

Total deposits increased \$5,109,000 or 0.8% to \$640,167,000 as of December 31, 2009 compared to \$635,058,000 as of December 31, 2008. Interest-bearing deposits increased \$7,585,000 or 1.6% to \$480,537,000 as of December 31, 2009 compared to \$472,952,000 as of December 31, 2008. Non-interest bearing deposits decreased \$2,476,000 or 1.5% to \$159,630,000 as of December 31, 2009 compared to \$162,106,000 as of December 31, 2008. Our total market share of deposits in Fresno, Madera, and San Joaquin counties was 3.50% in 2009 compared 2.40% in 2008 based on FDIC deposit market share information published as of June 30, 2009.

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

## FINANCIAL CONDITION (continued)

### Deposits and Borrowings (continued)

The composition of the deposits and average interest rates paid at December 31, 2009 and 2008 is summarized in the table below.

(Dollars in thousands)	December 31, 2009	% of Total Deposits	Effective Rate	December 31, 2008	% of Total Deposits	Effective Rate
NOW accounts	\$ 112,493	17.6%	0.66%	\$ 111,494	17.6%	0.47%
MMA accounts	142,917	22.3%	0.93%	128,239	20.2%	1.87%
Time deposits	200,681	31.4%	1.82%	211,987	33.4%	3.09%
Savings deposits	<u>24,446</u>	<u>3.8%</u>	0.22%	<u>21,232</u>	<u>3.3%</u>	0.35%
Total interest-bearing	480,537	75.1%	1.22%	472,952	74.5%	2.01%
Non-interest bearing	<u>159,630</u>	<u>24.9%</u>		<u>162,106</u>	<u>25.5%</u>	
Total deposits	<u>\$ 640,167</u>	<u>100.0%</u>		<u>\$ 635,058</u>	<u>100.0%</u>	

Short-term borrowings totaled \$5,000,000 as of December 31, 2009 compared to \$6,368,000 as of December 31, 2008. Short-term borrowings consist of overnight correspondent bank borrowings and FHLB advances maturing within one month. The maximum amount of short-term borrowings at any month-end during 2009, 2008 and 2007, was \$5,000,000, \$24,600,000, and \$20,000,000, respectively. We maintain a line of credit with the FHLB collateralized by government securities and loans. Refer to Liquidity section below for further discussion of FHLB advances.

Total long-term debt as of December 31, 2009 was \$14,000,000 and consisted of FHLB advances with interest rates ranging from of 3.00% to 3.59% with a weighted average rate of 3.20%, and maturing between 2011 and 2013. Long-term debt was \$19,000,000 as of December 31, 2008 with a weighted average rate of 3.08%. There was no long-term debt as of December 31, 2007.

The Company succeeded to all of the rights and obligations of Service 1<sup>st</sup> Capital Trust I, a Delaware business trust, in connection with the acquisition of Service 1<sup>st</sup> as of November 12, 2008. The Trust was formed on August 17, 2006 for the sole purpose of issuing trust preferred securities fully and unconditionally guaranteed by Service 1<sup>st</sup>. Under applicable regulatory guidance, the amount of trust preferred securities that is eligible as Tier 1 capital is limited to 25% of the Company's Tier 1 capital on a pro forma basis. At December 31, 2009, all of the trust preferred securities that have been issued qualify as Tier 1 capital. The trust preferred securities mature on October 7, 2036, are redeemable at the Company's option beginning after five years, and require quarterly distributions by the Trust to the holder of the trust preferred securities at a variable interest rate which will adjust quarterly to equal the three month LIBOR plus 1.60%.

The Trust used the proceeds from the sale of the trust preferred securities to purchase approximately \$5,155,000 in aggregate principal amount of Service 1<sup>st</sup>'s junior subordinated notes (the Notes). The Notes bear interest at the same variable interest rate during the same quarterly periods as the trust preferred securities. The Notes are redeemable by the Company on any January 7, April 7, July 7, or October 7 on or after October 7, 2011 or at any time within 90 days following the occurrence of certain events, such as: (i) a change in the regulatory capital treatment of the Notes (ii) in the event the Trust is deemed an investment company or (iii) upon the occurrence of certain adverse tax events. In each such case, the Company may redeem the Notes for their aggregate principal amount, plus any accrued but unpaid interest.

The Notes may be declared immediately due and payable at the election of the trustee or holders of 25% of the aggregate principal amount of outstanding Notes in the event that the Company defaults in the payment of any interest following the nonpayment of any such interest for 20 or more consecutive quarterly periods. Holders of the trust preferred securities are entitled to a cumulative cash distribution on the liquidation amount of \$1,000 per security. For each January 7, April 7, July 7 or October 7 of each year, the rate will be adjusted to equal the three month LIBOR plus 1.60%. As of December 31, 2009, the rate was 1.88%. Interest expense recognized by the Company for the year ended December 31, 2009 was \$129,000.

### Capital Resources

Capital serves as a source of funds and helps protect depositors and shareholders against potential losses. The primary source of capital for the Company has been internally generated capital through retained earnings.

The Company has historically maintained substantial levels of capital. The assessment of capital adequacy is dependent on several factors including asset quality, earnings trends, liquidity and economic conditions. Maintenance of adequate capital levels is integral to providing stability to the Company. The Company needs to maintain substantial levels of regulatory capital to give it maximum flexibility in the changing regulatory environment and to respond to changes in the market and economic conditions.

Our stockholders' equity increased to \$91,223,000 as of December 31, 2009 compared to \$75,375,000 as of December 31, 2008. The increase in stockholders' equity is a result of \$7,000,000 in preferred stock and common stock warrants issued to the Treasury under the Capital Purchase Program, \$7,758,000 from the Stock Purchase Agreements with accredited investors, net income of \$2,588,000 in 2009, the effect of stock-based compensation expense of \$284,000, decrease in unrealized income on the available-for-sale investment securities of \$1,643,000, offset by preferred stock dividends and accretion of discount of \$365,000.

We participated in the Treasury Capital Purchase Program under the Emergency Economic Stabilization Act. The Company issued preferred stock and a Warrant to issue common stock and received \$7,000,000 in cash under this program. The Company agreed to restrict dividend payments on common stock to no more than historic levels while our preferred stock is owned by the Treasury. See Note 12 to the audited Consolidated Financial Statements in this report for a more detailed discussion.

On December 23, 2009, the Company entered into Stock Purchase Agreements with a limited number of accredited investors to sell a total of 1,264,952 shares of common stock, without par value at \$5.25 per share, and 1,359 shares of non-voting Series B Convertible Adjustable Rate Non-Cumulative Perpetual Preferred Stock (Series B Preferred Stock) at \$1,000 per share, for an aggregate gross purchase price of \$8,000,000, offset by issuance expenses totaling \$242,000. See Note 12 to the audited Consolidated Financial Statements in this report for a more detailed discussion.

During 2009 the Bank did not pay any dividends to the Company. In 2008, the Bank declared and paid cash dividends to the Company of \$6,100,000, in connection with the acquisition of Service 1<sup>st</sup> and stock repurchase agreements approved by the Company's Board of Directors. The Bank would not pay any dividend that would cause it to be deemed not "well capitalized" under applicable banking laws and regulations.

Management considers capital requirements as part of its strategic planning process. The strategic plan calls for continuing increases in assets and liabilities, and the capital required may therefore be in excess of retained earnings. The ability to obtain capital is dependent upon the capital markets as well as our performance. Management regularly evaluates sources of capital and the timing required to meet its strategic objectives.

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

## FINANCIAL CONDITION (continued)

### Capital Resources (continued)

The following table presents the Company's and the Bank's capital ratios as of December 31, 2009 and 2008:

(Dollars in thousands)	December 31, 2009		December 31, 2008	
	Amount	Ratio	Amount	Ratio
<b>Tier 1 Leverage Ratio</b>				
Central Valley Community Bancorp and Subsidiary	\$ 67,547	9.30%	\$ 54,519	8.67%
Minimum regulatory requirement	\$ 29,056	4.00%	\$ 25,148	4.00%
Central Valley Community Bank	\$ 66,624	9.20%	\$ 51,296	8.18%
Minimum requirement for "Well-Capitalized" institution	\$ 36,210	5.00%	\$ 31,360	5.00%
Minimum regulatory requirement	\$ 28,968	4.00%	\$ 25,088	4.00%
<b>Tier 1 Risk-Based Capital Ratio</b>				
Central Valley Community Bancorp and Subsidiary	\$ 67,547	12.28%	\$ 54,519	9.33%
Minimum regulatory requirement	\$ 21,998	4.00%	\$ 23,374	4.00%
Central Valley Community Bank	\$ 66,624	12.12%	\$ 51,296	8.81%
Minimum requirement for "Well-Capitalized" institution	\$ 32,977	6.00%	\$ 34,934	6.00%
Minimum regulatory requirement	\$ 21,985	4.00%	\$ 23,289	4.00%
<b>Total Risk-Based Capital Ratio</b>				
Central Valley Community Bancorp and Subsidiary	\$ 74,463	13.54%	\$ 61,742	10.57%
Minimum regulatory requirement	\$ 43,996	8.00%	\$ 46,748	8.00%
Central Valley Community Bank	\$ 73,535	13.38%	\$ 58,519	10.05%
Minimum requirement for "Well-Capitalized" institution	\$ 54,962	10.00%	\$ 58,223	10.00%
Minimum regulatory requirement	\$ 43,970	8.00%	\$ 46,579	8.00%

## LIQUIDITY

Liquidity management involves our ability to meet cash flow requirements arising from fluctuations in deposit levels and demands of daily operations, which include funding of securities purchases, providing for customers' credit needs and ongoing repayment of borrowings. Our liquidity is actively managed on a daily basis and reviewed periodically by our management and Director's Asset/Liability Committees. This process is intended to ensure the maintenance of sufficient funds to meet our needs, including adequate cash flows for off-balance sheet commitments.

Our primary sources of liquidity are derived from financing activities which include the acceptance of customer and, to a lesser extent, broker deposits, Federal funds facilities and advances from the Federal Home Loan Bank of San Francisco. These funding sources are augmented by payments of principal and interest on loans, the routine maturities and pay downs of securities from the securities portfolio, the stability of our core deposits and the ability to sell investment securities. As of December 31, 2009, the Company had unpledged securities totaling \$70,734,000 available as a secondary source of liquidity. Primary uses of funds include withdrawal of and interest payments on deposits, origination and purchases of loans, purchases of investment securities, and payment of operating expenses.

As a means of augmenting our liquidity, we have established Federal funds lines with various correspondent banks. At December 31, 2009 our available borrowing capacity includes approximately \$39,000,000 in Federal funds lines with our correspondent banks and \$94,451,000 in unused FHLB advances. At December 31, 2009, we were not aware of any information that was reasonably likely to have a material effect on our liquidity position. The following table reflects the Company's credit lines, balances outstanding, and pledged collateral at December 31, 2009 and 2008:

Credit Lines (In thousands)	December 31, 2009	December 31, 2008
<b>Unsecured Credit Lines</b>		
(interest rate varies with market):		
Credit limit	\$ 39,000	\$ 39,000
Balance outstanding	\$ -	\$ 6,368
<b>Federal Home Loan Bank</b>		
(interest rate at prevailing interest rate):		
Credit limit	\$ 113,451	\$ 38,207
Balance outstanding	\$ 19,000	\$ 19,000
Collateral pledged	\$ 139,726	\$ 54,350
Fair value of collateral	\$ 144,903	\$ 52,783
<b>Federal Reserve Bank</b>		
(interest rate at prevailing discount interest rate):		
Credit limit	\$ 917	\$ 1,878
Balance outstanding	\$ -	\$ -
Collateral pledged	\$ 922	\$ 1,885
Fair value of collateral	\$ 956	\$ 1,929

The liquidity of our parent company, Central Valley Community Bancorp, is primarily dependent on the payment of cash dividends by its subsidiary, Central Valley Community Bank, subject to limitations imposed by regulations.

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

### OFF-BALANCE SHEET ITEMS

In the ordinary course of business, the Company is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received. The balance of commitments to extend credit on undisbursed construction and other loans and letters of credit was \$131,139,000 as of December 31, 2009 compared to \$160,450,000 as of December 31, 2008. For a more detailed discussion of these financial instruments, see Note 11 to the audited Consolidated Financial Statements in this Annual Report.

In the ordinary course of business, the Company is party to various operating leases. For a more detailed discussion of these financial instruments, see Note 11 to the audited Consolidated Financial Statements in this Annual Report.

### CONTRACTUAL OBLIGATIONS

The following summarizes the Company's long-term contractual obligations at December 31, 2009:

<u>(In thousands)</u>	Less than 1 year	1 - 3 years	3 - 5 years	Thereafter	Total
Time deposits	\$ 177,592	\$ 16,509	\$ 6,578	\$ 2	\$ 200,681
FHLB Advances	5,000	10,000	4,000	-	19,000
Deferred Compensation Liability (1)	1,992	-	-	-	1,992
Salary Continuation Liability (1)	782	538	600	2,862	4,782
Obligations reflected on Consolidated Balance Sheet	<u>\$ 185,366</u>	<u>\$ 27,047</u>	<u>\$ 11,178</u>	<u>\$ 2,864</u>	<u>\$ 226,455</u>
Operating lease obligations	<u>\$ 1,772</u>	<u>\$ 3,333</u>	<u>\$ 2,950</u>	<u>\$ 6,162</u>	<u>\$ 14,217</u>
Obligations not reflected on Consolidated Balance Sheet	<u>\$ 1,772</u>	<u>\$ 3,333</u>	<u>\$ 2,950</u>	<u>\$ 6,162</u>	<u>\$ 14,217</u>

(1) These amounts represent the current accrual for payments to participants under the Company's deferred compensation and salary continuation plans. See Note 14 to the audited Consolidated Financial Statements.

### QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest rate risk (IRR) and credit risk constitute the two greatest sources of financial exposure for insured financial institutions that operate like we do. IRR represents the impact that changes in absolute and relative levels of market interest rates may have upon our net interest income (NII). Changes in the NII are the result of changes in the net interest spread between interest-earning assets and interest-bearing liabilities (timing risk), the relationship between various rates (basis risk), and changes in the shape of the yield curve.

We realize income principally from the differential or spread between the interest earned on loans, investments, other interest-earning assets and the interest incurred on deposits and borrowings. The volumes and yields on loans, deposits and borrowings are affected by market interest rates. As of December 31, 2009, 76.2% of our loan portfolio was tied to adjustable-rate indices. The majority of our adjustable rate loans are tied to prime and reprice within 90 days. However, in the current low rate environment, several of our loans, tied to prime, are at their floors and will not reprice until prime plus the factor is greater than the floor. The majority of our time deposits have a fixed rate of interest. As of December 31, 2009, 88.8% of our time deposits mature within one year or less. As of December 31, 2009, \$5,000,000 of our short term debt and \$14,000,000 of our long-term debt was fixed rate. Our long-term debt has maturities through 2013.

Changes in the market level of interest rates directly and immediately affect our interest spread, and therefore profitability. Sharp and significant changes to market rates can cause the interest spread to shrink or expand significantly in the near term, principally because of the timing differences between the adjustable rate loans and the maturities (and therefore repricing) of the deposits and borrowings.

Our management and Board of Directors' Asset/Liability Committees (ALCO) are responsible for managing our assets and liabilities in a manner that balances profitability, IRR and various other risks including liquidity. The ALCO operates under policies and within risk limits prescribed, reviewed, and approved by the Board of Directors.

The ALCO seeks to stabilize our NII by matching rate-sensitive assets and liabilities through maintaining the maturity and repricing of these assets and liabilities at appropriate levels given the interest rate environment. When the amount of rate-sensitive liabilities exceeds rate-sensitive assets within specified time periods, NII generally will be negatively impacted by an increasing interest rate environment and positively impacted by a decreasing interest rate environment. Conversely, when the amount of rate-sensitive assets exceeds the amount of rate-sensitive liabilities within specified time periods, net interest income will generally be positively impacted by an increasing interest rate environment and negatively impacted by a decreasing interest rate environment. The speed and velocity of the repricing of assets and liabilities will also contribute to the effects on our NII, as will the presence or absence of periodic and lifetime interest rate caps and floors.

Simulation of earnings is the primary tool used to measure the sensitivity of earnings to interest rate changes. Earnings simulations are produced using a software model that is based on actual cash flows and repricing characteristics for all of our financial instruments and incorporates market-based assumptions regarding the impact of changing interest rates on current volumes of applicable financial instruments.

Interest rate simulations provide us with an estimate of both the dollar amount and percentage change in NII under various rate scenarios. All assets and liabilities are normally subjected to up to 300 basis point increases and decreases in interest rates in 100 basis point increments. Under each interest rate scenario, we project our net interest income. From these results, we can then develop alternatives in dealing with the tolerance thresholds.

Approximately 76.2% of our loan portfolio is tied to adjustable rate indices and 46.5% of our loan portfolio reprices within 90 days. As of December 31, 2009, we had 483 commercial and real estate loans totaling \$158,586,000 with floors ranging from 1% to 8.25% and ceilings ranging from 7% to 25%.

The following table shows the effects of changes in projected net interest income for the twelve months ending December 31, 2010 under the interest rate shock scenarios stated. The table was prepared as of December 31, 2009, using a prime interest rate of 3.25%.

# Management's Discussion and Analysis

## of Financial Condition and Results of Operations

### QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (continued)

#### Sensitivity Analysis of Impact of Rate Changes on Interest Income

Hypothetical Change In Rates	Projected Net Interest Income	\$ Change From Rates At December 31, 2009	% Change From Rates At December 31, 2009
(Dollars in thousands)			
UP 300 bp	\$ 33,597	\$ 1,936	6.12%
UP 200 bp	32,613	952	3.01%
UP 100 bp	31,826	165	0.52%
UNCHANGED	31,661	-	-
DOWN 25 bp	31,714	53	0.17%

Assumptions are inherently uncertain, and, consequently, the model cannot precisely measure net interest income or precisely predict the impact of changes in interest rates on net interest income. Actual results will differ from simulated results due to timing, magnitude and frequency of interest rate changes, as well as changes in market conditions and management strategies which might moderate the negative consequences of interest rate deviations.

There is no material change in our current market risk exposure from the market risk exposure we experienced in 2009. The outcome of the sensitivity analysis conducted for 2008 was essentially the same as 2009.

### CRITICAL ACCOUNTING POLICIES

The Securities and Exchange Commission (SEC) has issued disclosure guidance for "critical accounting policies." The SEC defines "critical accounting policies" as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in future periods.

Our accounting policies are integral to understanding the results reported. Our significant accounting policies are described in detail in Note 1 in the audited Consolidated Financial Statements. Not all of the significant accounting policies presented in Note 1 of the audited Consolidated Financial Statements in this Annual Report require management to make difficult, subjective or complex judgments or estimates.

#### **Use of Estimates**

The preparation of these financial statements requires management to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses. On an ongoing basis, management evaluates the estimates used. Estimates are based upon historical experience, current economic conditions and other factors that management considers reasonable under the circumstances.

These estimates result in judgments regarding the carrying values of assets and liabilities when these values are not readily available from other sources, as well as assessing and identifying the accounting treatments of contingencies and commitments. Actual results may differ from these estimates under different assumptions.

#### **Accounting Principles Generally Accepted in the United States of America**

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP).

We follow accounting policies typical to the commercial banking industry and in compliance with various regulation and guidelines as established by the Public Company Accounting Oversight Board (PCAOB), Financial Accounting Standards Board (FASB), the American Institute of Certified Public Accountants (AICPA), and the Bank's primary federal regulator, the FDIC. The following is a brief description of our current accounting policies involving *significant* management judgments.

#### **Allowance for Credit Losses**

Our most significant management accounting estimate is the appropriate level for the allowance for credit losses. The allowance for credit losses is established to absorb known and inherent losses attributable to loans outstanding. The adequacy of the allowance is monitored on an on-going basis and is based on our management's evaluation of numerous factors. These factors include the quality of the current loan portfolio, the trend in the loan portfolio's risk ratings, current economic conditions, loan concentrations, loan growth rates, past-due and nonperforming trends, evaluation of specific loss estimates for all significant problem loans, historical charge-off and recovery experience and other pertinent information.

The calculation of the allowance for credit losses is by nature inexact, as the allowance represents our management's best estimate of the probable losses inherent in our credit portfolios at the reporting date. These credit losses will occur in the future, and as such cannot be determined with absolute certainty at the reporting date.

#### **Impairment of Investment Securities**

Investment securities are impaired when the amortized cost exceeds fair value. Investment securities are evaluated for impairment 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. Once a decline in value is determined to be other-than-temporary and we do not intend to sell the security or it is more likely than not that we 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 we will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings.



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

## CRITICAL ACCOUNTING POLICIES (continued)

### **Amortization of Premiums/Discount Accretion on Investments**

We invest in Collateralized Mortgage Obligations (CMO) and Mortgage Backed Securities, (MBS) as part of the overall strategy to increase our net interest margin. CMOs and MBS by their nature react to changes in interest rates. In a normal declining rate environment, prepayments from MBS and CMOs would be expected to increase and the expected life of the investment would be expected to shorten. Conversely, if interest rates increase, prepayments normally would be expected to decline and the average life of the MBS and CMOs would be expected to extend. However, in the current economic environment, prepayments may not behave according to historical norms. Premium amortization and discount accretion of these investments affects our net interest income. Our management monitors the prepayment speed of these investments and adjusts premium amortization and discount accretion based on several factors. These factors include the type of investment, the investment structure, interest rates, interest rates on new mortgage loans, expectation of interest rate changes, current economic conditions, the level of principal remaining on the bond, the bond coupon rate, the bond origination date, and volume of available bonds in market. The calculation of premium amortization and discount accretion is by nature inexact, and represents management's best estimate of principal pay downs inherent in the total investment portfolio.

### **Goodwill**

Business combinations involving the Company's acquisition of the 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 in transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Company's ability to generate net earnings after the acquisition. 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 a reporting unit level at least annually or more often if an event occurs or circumstances change that would more likely than not reduce the fair value of the Company below its carrying amount. While the Company believes all assumptions utilized in its assessment of goodwill for impairment are reasonable and appropriate, changes could cause the Company to record impairment in the future.

### **Share-Based Compensation**

The Company recognizes compensation expense in an amount equal to the fair value of all share-based payments which consist of stock options granted to directors and employees. The fair value of each option 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 to estimate the grant date fair value. The estimates are based on assumptions on the expected option life, the level of estimated forfeitures, expected stock volatility and the risk-free interest rate. The calculation of the fair value of share based payments is by nature inexact, and represents management's best estimate of the grant date fair value of the share based payments. See Note 1 to the audited Consolidated Financial Statements in this Annual Report.

### **Accounting for Income Taxes**

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

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. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. On the balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred income tax assets is assessed and a valuation allowance is recorded if is "more likely than not" that all or a portion of the deferred tax asset will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed.

Only tax positions that meet the more-likely-than-not recognition threshold are recognized. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest expense and penalties associated with unrecognized tax benefits are classified as income tax expense in the consolidated statement of income.

## INFLATION

The impact of inflation on a financial institution differs significantly from that exerted on other industries primarily because the assets and liabilities of financial institutions consist largely of monetary items. However, financial institutions are affected by inflation in part through non-interest expenses, such as salaries and occupancy expenses, and to some extent by changes in interest rates.

At December 31, 2009, we do not believe that inflation will have a material impact on our consolidated financial position or results of operations. However, if inflation concerns cause short term rates to rise in the near future, we may benefit by immediate repricing of a majority of our loan portfolio. Refer to Market Risk section for further discussion.

## Stock Price Information

### Stock Price Information

The Company's common stock is listed for trading on the NASDAQ Capital Market under the ticker symbol CVCY. As of March 5, 2010, the Company had approximately 758 shareholders of record.

The following table shows the high and low sales prices for the common stock for each quarter as reported by NASDAQ.

Quarter Ended	Sales Prices for the Company's Common Stock	
	Low	High
March 31, 2008	\$ 9.60	\$ 13.24
June 30, 2008	9.40	10.99
September 30, 2008	7.30	10.25
December 31, 2008	4.59	8.98
March 31, 2009	3.53	7.34
June 30, 2009	4.05	5.98
September 30, 2009	5.11	5.90
December 31, 2009	5.08	5.75

The Company did not pay a cash dividend in 2009. The Company paid \$0.10 per share cash dividends in 2008. The Company's primary source of income with which to pay cash dividends is dividends from the Bank. The Bank would not pay any dividend that would cause it to be deemed not "well capitalized" under applicable banking laws and regulations. See Note 12 in the audited Consolidated Financial Statements in Item 8 of this Annual Report.

### Market Makers

Inquiries on Central Valley Community Bancorp stock can be made by calling any of the contacts listed below, or any licensed stockbroker.

Dave Bonaccorso  
Keefe Bruyette & Woods  
(415) 591-5063

Jeffrey Mayer  
Crowell, Weedon & Co.  
(559) 375-7510

John Cavender  
Howe Barnes Hoefler & Arnett  
(415) 538-5725

Troy Norlander  
Stone & Youngberg  
(800) 288-2811

Lisa Gallo  
Wedbush Morgan Securities  
(866) 491-7228

Joey Warmenhoven  
McAdams Wright Ragen, Inc.  
(866) 662-0351

Richard Levenson  
Western Financial Corporation  
(800) 488-5990

### Shareholder Inquiries

Inquiries regarding Central Valley Community Bancorp's accounting, internal accounting controls or auditing concerns should be directed to Steven D. McDonald, chairman of the Board of Directors' Audit Committee, at [steve.mcdonald@cvcb.com](mailto:steve.mcdonald@cvcb.com), anonymously at [www.ethicspoint.com](http://www.ethicspoint.com) or call Ethics Point, Inc. at (866) 294-9588.

General inquiries about the Company or the Bank should be directed to Cathy Ponte, Assistant Corporate Secretary at (800) 298-1775.

## Board of Directors



From Top Left to Right:

**Edwin S. Darden, Jr.**  
*President*  
*Darden Architects, Inc.*

**Steven D. McDonald**  
*Secretary of the Board,*  
*President*  
*McDonald Properties, Inc.*

**William S. Smittcamp**  
*President/Owner*  
*Wawona Frozen Foods*

**Louis C. McMurray**  
*President*  
*Charles McMurray Co.*

**Joseph B. Weirick**  
*Investments*

Seated Left to Right:

**Daniel J. Doyle**  
*President and CEO*  
*Central Valley Community Bancorp,*  
*Central Valley Community Bank*

**Daniel N. Cunningham**  
*Chairman of the Board,*  
*Director*  
*Quinn Group, Inc.*

**Sidney B. Cox**  
*Owner*  
*Cox Communications*

Not Pictured:  
**Wanda L. Rogers**  
*Director Emeritus,*  
*President*  
*Rogers Helicopters, Inc.*

### Core Values

Leadership  
Integrity  
Loyalty  
Caring  
Teamwork  
Trustworthiness

### San Joaquin County Advisory Board

An advisory board for the San Joaquin County region provides local market knowledge and assists with strategic growth opportunities for the Bank. Members of the advisory board include:

Sidney Alegre  
Judith Buehe  
Mary Ghio  
Phil Katakian  
George Liepart  
Clark Mizuno  
Rick Paulsen  
Russell Ray  
Penny van der Meer

### Exceptional Employees

Each year Central Valley Community Bank's top-performing employees are recognized in the Circle of Excellence, and from that group, the best are designated to the Circle of Elite.

*The 2009 Circle of Elite included:*

Beth Buffington  
*Utility Central Operations*

Gloria Carter  
*Retail Administrative Coordinator*

Jacquelin Flores  
*Customer Service Representative*

Shawn Kruitbosch  
*Assistant Vice President, Small Business Loan Underwriter*

Wendy Parlavocchio  
*Assistant Vice President, Mortgage Loan Officer*

Susan Rodriguez  
*Accounting Assistant/Team Leader Contract Administrator*

Karen Smith  
*Vice President, Branch Manager*

Jennette Williams  
*Vice President, Commercial Loan Officer/Team Leader*

## Officers

### *Holding Company and Bank Officers:*

Daniel J. Doyle  
President and Chief Executive Officer

David A. Kinross  
Senior Vice President,  
Chief Financial Officer

Thomas L. Sommer  
Senior Vice President,  
Credit Administrator

### *Bank Officers:*

Bryan Hyzdu  
Senior Vice President,  
San Joaquin County Region

Gary Quisenberry  
Senior Vice President,  
Commercial and Business Banking

Lydia Shaw  
Senior Vice President,  
Consumer and Retail Banking

Shelle Abbott  
Vice President,  
Branch Manager

Susan Armstrong  
Vice President,  
Branch Manager

Jacquie Ashjian  
Vice President,  
Credit Administration

Patrick Carman  
Vice President,  
Credit Administration

Cyndi Carmichael  
Vice President,  
Compliance Officer

Vicki Casares  
Vice President,  
Branch Manager

Cathy Chatoian  
Vice President,  
Cash Management Manager

Terry Crawford  
Vice President,  
Agricultural Lending Group Manager

Tom Crawley  
Vice President,  
Commercial Loan Officer

Stan Davis  
Vice President,  
Small Business/Consumer Loan Underwriting  
Department Manager

Daniel Demmers  
Vice President,  
Information Services Manager

Ken Dodderer  
Vice President,  
Commercial Loan Officer

Bob Elledge  
Vice President,  
Commercial Loan Officer

Steve Freeland  
Vice President,  
Special Assets Officer

Rod Geist  
Vice President,  
Branch Manager

Teresa Gilio  
Vice President,  
Central Operations Manager

Diane Hamp  
Vice President,  
Loan Services Manager

Tim Harris  
Vice President,  
Private Banking Manager

Charles Jones  
Vice President,  
Branch Manager

Deby Jordan  
Vice President,  
Private Banking Officer

Bernie Kraus  
Vice President,  
Commercial Loan Officer/Team Leader

Mari Kroigaard  
Vice President,  
SBA Department Manager

Brad Majors  
Vice President,  
Branch Manager

Gina Manley  
Vice President,  
Branch Manager

Rona Melkus  
Vice President,  
Controller

Don Mendenhall  
Vice President,  
Commercial Loan Officer

Sheryl Michael  
Vice President,  
Branch Manager

Heather Mills  
Vice President,  
Private Banking Officer

Steve Mizuno  
Vice President,  
Commercial Loan Officer/Team Leader

Autumn Muller-Carrillo  
Vice President,  
Branch Manager

Frank Oliver  
Vice President,  
Commercial Loan Officer

Jean Ornelas  
Vice President,  
Real Estate Construction Loan Officer

Jeff Pace  
Vice President,  
Real Estate Department Manager

Shannon Reinard  
Vice President,  
Branch Manager

John Royal  
Vice President,  
Commercial Loan Officer

Elizabeth Salas  
Vice President,  
Branch Manager

Karen Smith  
Vice President,  
Branch Manager

Theodore Thome  
Vice President,  
Commercial Loan Officer/Team Leader

Doug Van den Enden  
Vice President,  
Commercial Loan Officer

Jim Van Tassel  
Vice President,  
Commercial Loan Officer

Robert Walker  
Vice President,  
Commercial Loan Officer

Jeannine Welton  
Vice President,  
Branch Manager

Jennette Williams  
Vice President,  
Commercial Loan Officer/Team Leader

Carol Worstein  
Vice President,  
Branch Manager

### *Independent Auditors*

Perry-Smith LLP, Sacramento, CA

### *Counsel*

Downey Brand LLP, Sacramento, CA





## CLOVIS

### **Clovis Main**

600 Pollasky Avenue  
Clovis, CA 93612  
(559) 323-3480

### **Herndon & Fowler**

1795 Herndon Avenue,  
Suite 101  
Clovis, CA 93611  
(559) 323-2200

## FRESNO

### **Fig Garden Village**

5180 North Palm,  
Suite 105  
Fresno, CA 93704  
(559) 221-2760

### **Financial Drive**

**Corporate Office**  
7100 North Financial Drive,  
Suite 101  
Fresno, CA 93720  
(559) 298-1775  
(800) 298-1775

### **Fresno Downtown**

2404 Tulare Street  
Fresno, CA 93721  
(559) 268-6806

### **River Park**

8375 North Fresno Street  
Fresno, CA 93720  
(559) 447-3350

### **Sunnyside**

570 South Clovis Avenue,  
Suite 101  
Fresno, CA 93727  
(559) 323-3400

### **Kerman**

360 South Madera Avenue  
Kerman, CA 93630  
(559) 842-2265

### **Lodi**

1901 West Kettleman Lane,  
Suite 100  
Lodi, CA 95242  
(209) 333-5000

### **Madera**

1919 Howard Road  
Madera, CA 93637  
(559) 673-0395

### **Merced**

2832 North G Street  
Merced, CA 95340  
(209) 725-2820

### **Modesto**

3340 Tully Road,  
Suite C-3  
Modesto, CA 95350  
(209) 576-1402

### **Oakhurst**

40004 Highway 41  
Suite 101  
Oakhurst, CA 93644  
(559) 642-2265

### **Prather**

29430 Auberry Road  
Prather, CA 93651  
(559) 855-4100

### **Sacramento**

2339 Gold Meadow Way,  
Suite 100  
Gold River, CA 95670  
(916) 859-2550

### **Stockton**

2800 West March Lane,  
Suite 120  
Stockton, CA 95219  
(209) 956-7800

### **Tracy**

60 West 10th Street  
Tracy, CA 95376  
(209) 830-6995

## BUSINESS LENDING

### **Business Lending**

7100 North Financial Drive,  
Suite 101  
Fresno, CA 93720  
(559) 298-1775  
(800) 298-1775

### **Agribusiness**

8375 North Fresno Street  
Fresno, CA 93720  
(559) 323-3493

### **Real Estate**

7100 North Financial Drive,  
Suite 101  
Fresno, CA 93720  
(559) 323-3365

### **SBA Lending**

7100 North Financial Drive,  
Suite 101  
Fresno, CA 93720  
(559) 323-3384

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