

AMERICAN RIVER BANKSHARES

Form 10-Q

August 09, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018
or

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

For the transition period from to

Commission File Number: 0-31525

AMERICAN RIVER BANKSHARES

(Exact name of registrant as specified in its charter)

California
(State or other jurisdiction of incorporation or organization)

68-0352144
(I.R.S. Employer Identification No.)

3100 Zinfandel Drive, Suite 450, Rancho Cordova, California
(Address of principal executive offices)

95670
(Zip Code)

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(916) 851-0123

(Registrant's telephone number, including area code)

Not Applicable

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

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

No par value Common Stock – 5,864,802 shares outstanding at August 9, 2018.

AMERICAN RIVER BANKSHARES

**INDEX TO QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2018**

		Page
Part I.		
<u>Item 1.</u>	<u>Financial Statements</u>	3
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	29
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	48
<u>Item 4.</u>	<u>Controls and Procedures</u>	49
Part II.		
<u>Item 1.</u>	<u>Legal Proceedings</u>	49
<u>Item 1A.</u>	<u>Risk Factors</u>	49
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	49
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	50
<u>Item 4.</u>	<u>Mine Safety Disclosures</u>	50
<u>Item 5.</u>	<u>Other Information</u>	50
<u>Item 6.</u>	<u>Exhibits</u>	50
Signatures		51
Exhibit Index		52
31.1	Certifications of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	53
31.2	Certifications of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	54
32.1	Certification of American River Bankshares by its Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	55
101.INS	XBRL Instance Document	
101.SCH	XBRL Taxonomy Extension Schema	
101.CAL	XBRL Taxonomy Extension Calculation	
101.DEF	XBRL Taxonomy Extension Definition	
101.LAB	XBRL Taxonomy Extension Label	
101.PRE	XBRL Taxonomy Extension Presentation	

PART I-FINANCIAL INFORMATION**Item 1. Financial Statements.**AMERICAN RIVER BANKSHARES
CONSOLIDATED BALANCE SHEET

(Unaudited)

(dollars in thousands)	June 30, 2018	December 31, 2017
ASSETS		
Cash and due from banks	\$45,068	\$ 38,467
Federal funds sold	8,000	—
Total cash and cash equivalents	53,068	38,467
Interest-bearing deposits in banks	1,746	1,746
Investment securities:		
Available-for-sale, at fair value	281,660	262,322
Held-to-maturity, at amortized cost	330	378
Loans and leases, less allowance for loan and lease losses of \$4,492 at June 30, 2018 and \$4,478 at December 31, 2017	290,552	308,713
Premises and equipment, net	1,084	1,158
Federal Home Loan Bank stock	3,932	3,932
Goodwill and other intangible assets	16,321	16,321
Other real estate owned	961	961
Bank owned life insurance	15,273	15,122
Accrued interest receivable and other assets	10,329	6,502
	\$675,256	\$ 655,622
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest bearing	\$221,402	\$ 215,528
Interest-bearing	359,914	340,552
Total deposits	581,316	556,080
Short-term borrowings	6,500	3,500
Long-term borrowings	9,000	12,000
Accrued interest payable and other liabilities	6,547	7,121
Total liabilities	603,363	578,701
Commitments and contingencies		

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Shareholders' equity:

Preferred stock, no par value; 10,000,000 shares authorized; none outstanding	—	—
Common stock, no par value; 20,000,000 shares authorized; issued and outstanding – 5,864,802 shares at June 30, 2018 and 6,132,362 shares at December 31, 2017	30,082	34,463
Retained earnings	44,801	42,779
Accumulated other comprehensive loss, net of taxes	(2,990)	(321)
Total shareholders' equity	71,893	76,921
	\$675,256	\$ 655,622

See Notes to Unaudited Consolidated Financial Statements

AMERICAN RIVER BANKSHARES

CONSOLIDATED STATEMENT OF INCOME

(Unaudited)

(dollars in thousands, except per share data)

For the periods ended June 30,

	Three months		Six months	
	2018	2017	2018	2017
Interest income:				
Interest and fees on loans:				
Taxable	\$3,483	\$3,458	\$6,811	\$6,888
Exempt from Federal income taxes	128	133	256	266
Interest on Federal funds sold	98	—	148	—
Interest on deposits in banks	7	3	13	5
Interest and dividends on investment securities:				
Taxable	1,637	1,363	3,028	2,686
Exempt from Federal income taxes	145	159	308	316
Dividends	—	5	—	13
Total interest income	5,498	5,121	10,564	10,174
Interest expense:				
Interest on deposits	324	203	599	397
Interest on borrowings	54	49	108	97
Total interest expense	378	252	707	494
Net interest income	5,120	4,869	9,857	9,680
Provision for loan and lease losses	—	—	—	—
Net interest income after provision for loan and lease losses	5,120	4,869	9,857	9,680
Noninterest income:				
Service charges on deposit accounts	116	114	233	231
Gain on sale or call of investment securities	10	86	11	142
Other noninterest income	254	239	508	485
Total noninterest income	380	439	752	858
Noninterest expense:				
Salaries and employee benefits	2,517	2,064	4,723	4,234
Occupancy	262	262	524	531
Furniture and equipment	136	147	274	298
Federal Deposit Insurance Corporation assessments	53	52	106	105
Expenses related to other real estate owned	(3)	12	2	32
Other expense	863	831	1,549	1,598
Total noninterest expense	3,828	3,368	7,178	6,798
Income before provision for income taxes	1,672	1,940	3,431	3,740
Provision for income taxes	403	643	809	1,259

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Net income	\$1,269	\$1,297	\$2,622	\$2,481
Basic earnings per share	\$0.22	\$0.20	\$0.44	\$0.38
Diluted earnings per share	\$0.22	\$0.20	\$0.44	\$0.38
Cash dividends per share	\$0.05	\$0.05	\$0.10	\$0.10

See notes to Unaudited Consolidated Financial Statements

AMERICAN RIVER BANKSHARES

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(Unaudited)

(dollars in thousands, except per share data)

For the periods ended June 30,

	Three months		Six months	
	2018	2017	2018	2017
Net income	\$1,269	\$1,297	\$2,622	\$2,481
Other comprehensive income:				
(Decrease) increase in net unrealized gains on investment securities	(1,150)	412	(3,862)	873
Deferred tax benefit (expense)	367	(166)	1,200	(344)
Increase in net unrealized (losses) gains on investment securities, net of tax	(783)	246	(2,662)	529
Reclassification adjustment for realized gains included in net income	(10)	(86)	(11)	(142)
Tax effect	3	35	4	57
Realized gains, net of tax	(7)	(51)	(7)	(85)
Total other comprehensive (loss) gain income	(790)	195	(2,669)	444
Comprehensive income (loss)	\$479	\$1,492	\$(47)	\$2,925

See Notes to Unaudited Consolidated Financial Statements

AMERICAN RIVER BANKSHARES

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(Unaudited)

(dollars in thousands)	Common Stock		Retained Earnings	Accumulated	Total Shareholders' Equity
	Shares	Amount		Other Comprehensive Income (Loss)	
Balance, January 1, 2017	6,661,726	\$42,484	\$40,822	\$ 544	\$ 83,850
Net income			2,481		2,481
Other comprehensive income, net of tax				444	444
Cash dividends (\$0.10 per share)			(657)		(657)
Net restricted stock award activity and related compensation expense	22,032	181			181
Stock options exercised	7,095	60			60
Stock option compensation expense	—	20			20
Retirement of common stock	(333,086)	(5,006)			(5,006)
Balance, June 30, 2017	6,357,767	\$37,739	\$42,646	\$ 988	\$ 81,373
Balance, January 1, 2018	6,132,362	34,463	42,779	(321)	76,921
Net income			2,622		2,622
Other comprehensive loss, net of tax				(2,669)	(2,669)
Cash dividends (\$0.10 per share)			(601)		(601)
Net restricted stock award activity and related compensation expense	17,859	136	1		137
Stock options exercised	13,359	123			123
Stock option compensation expense	—	14			14
Retirement of common stock	(298,778)	(4,654)			(4,654)
Balance, June 30, 2018	5,864,802	\$30,082	\$44,801	\$ (2,990)	\$ 71,893

See Notes to Unaudited Consolidated Financial Statements

AMERICAN RIVER BANKSHARES

CONSOLIDATED STATEMENT OF CASH FLOWS
(Unaudited)

(dollars in thousands)

For the six months ended June 30,

	2018	2017
Cash flows from operating activities:		
Net income	\$2,622	\$2,481
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	—	—
Increase in deferred loan origination fees, net	93	3
Depreciation and amortization	138	173
Gain on sale and call of investment securities, net	(11)	(142)
Amortization of investment security premiums and discounts, net	1,491	1,648
Increase in cash surrender values of life insurance policies	(151)	(157)
Stock based compensation expense	151	201
Increase in accrued interest receivable and other assets	(2,604)	(98)
Decrease in accrued interest payable and other liabilities	(574)	(442)
Net cash provided by operating activities	1,155	3,667
Cash flows from investing activities:		
Proceeds from the sale of available-for-sale investment securities	14,443	17,605
Proceeds from matured available-for-sale investment securities	—	1,930
Proceeds from called available-for-sale investment securities	1,499	145
Purchases of available-for-sale investment securities	(61,756)	(45,419)
Proceeds from principal repayments for available-for-sale investment securities	21,105	21,513
Proceeds from principal repayments for held-to-maturity investment securities	48	54
Net increase in interest-bearing deposits in banks	—	(249)
Net decrease in loans	18,067	7,937
Net increase in FHLB stock	—	(153)
Purchases of equipment	(64)	(86)
Net cash (used in) provided by investing activities	(6,658)	3,277

7

AMERICAN RIVER BANKSHARES

CONSOLIDATED STATEMENT OF CASH FLOWS (Continued)
(Unaudited)

(dollars in thousands)

For the six months ended June 30,

	2018	2017
Cash flows from financing activities:		
Net increase (decrease) in demand, interest-bearing and savings deposits	\$27,717	\$(4,771)
Net decrease in time deposits	(2,481)	(2,155)
Net increase (decrease) in short-term borrowings	3,000	(1,500)
Net (decrease) increase in long-term borrowings	(3,000)	1,500
Proceeds from stock option exercise	123	60
Cash dividends paid	(601)	(657)
Cash paid to repurchase common stock	(4,654)	(5,006)
Net cash provided by (used in) financing activities	\$20,104	\$(12,529)
Increase (decrease) in cash and cash equivalents	14,601	(5,585)
Cash and cash equivalents at beginning of year	38,467	27,589
Cash and cash equivalents at end of period	\$53,068	\$22,004

See Notes to Unaudited Consolidated Financial Statements

AMERICAN RIVER BANKSHARES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

1. CONSOLIDATED FINANCIAL STATEMENTS

In the opinion of management, the unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the consolidated financial position of American River Bankshares (the “Company”) at June 30, 2018 and December 31, 2017, the results of its operations and statement of comprehensive income for the three-month and six-month periods ended June 30, 2018 and 2017, its cash flows for the six-month periods ended June 30, 2018 and 2017 and its statement of changes in shareholders’ equity for the six months ended June 30, 2018 and 2017 in conformity with accounting principles generally accepted in the United States of America.

Certain disclosures normally presented in the notes to the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The Company believes that the disclosures are adequate to make the information not misleading. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2017. The results of operations for the three-month and six-month periods ended June 30, 2018 may not necessarily be indicative of the operating results for the full year.

In preparing such financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates.

Management has determined that since all of the banking products and services offered by the Company are available in each branch office of American River Bank, all branch offices 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 all of the branch offices and report them as a single operating segment. No client accounts for more than ten percent (10%) of revenues for the Company or American River Bank.

Adoption of New Accounting Standard: On January 1, 2018, the Company adopted ASU 2014-09 “*Revenue from Contracts with Customers*” and all subsequent amendments to the ASU (collectively, “ASC 606”), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as Other Real Estate

Owned (“OREO”). The majority of the Company’s revenues come from interest income and other sources, including loans, leases, and securities that are outside the scope of ASC 606. The Company’s services that fall within the scope of ASC 606 are presented within Non-Interest Income and are recognized as revenue as the Company satisfies its obligation to the customer. Services within the scope of ASC 606 include deposit service charges on deposits, interchange income, and the sale of OREO. Refer to Note 13 “*Revenue from Contracts with Customers*” for further discussion on the Company’s accounting policies for revenue sources within the scope of ASC 606.

2. STOCK-BASED COMPENSATION

Equity Plans

On March 17, 2010, the Board of Directors adopted the 2010 Equity Incentive Plan (the “2010 Plan”). The 2010 Plan was approved by the Company’s shareholders on May 20, 2010. In 2000, the Board of Directors adopted and the Company’s shareholders approved a stock option plan (the “2000 Plan”), under which 18,041 options remain outstanding at June 30, 2018. At June 30, 2018, under the 2010 Plan, there were 31,008 stock options and 41,457 restricted shares outstanding and the total number of authorized shares that remain available for issuance was 1,290,590. The 2010 Plan provides for the following types of stock-based awards: incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted performance stock, unrestricted Company stock, and performance units. Awards under the 2000 Plan were either incentive stock options or nonqualified stock options. Under the 2010 Plan, the awards may be granted to employees and directors under incentive and nonqualified option agreements, restricted stock agreements, and other awards agreements. The unvested restricted stock under the 2010 Plan have dividend and voting rights. The 2010 Plan and the 2000 Plan (collectively the “Plans”) require that the option price may not be less than the fair market value of the stock at the date the option is awarded. The option awards under the Plans expire on dates determined by the Board of Directors, but not later than ten years from the date of award. The vesting period is generally five years; however, the vesting period can be modified at the discretion of the Company’s Board of Directors. Outstanding option awards under the Plans are exercisable until their expiration, however, no new options may be awarded under the 2000 Plan. New shares are issued upon exercise of an option.

The award date fair value of awards is determined by the market price of the Company's common stock on the date of award and is recognized ratably as compensation expense or director expense over the vesting periods. The shares of common stock awarded pursuant to such agreements vest in increments over one to five years from the date of award. The shares awarded to employees and directors under the restricted stock agreements vest on the applicable vesting dates only to the extent the recipient of the shares is then an employee or a director of the Company or one of its subsidiaries, and each recipient will forfeit all of the shares that have not vested on the date his or her employment or service is terminated.

Equity Compensation

For the three-month periods ended June 30, 2018 and 2017, the compensation cost recognized for equity compensation was \$78,000 and \$100,000, respectively. The recognized tax benefit for equity compensation expense was \$19,000 and \$36,000, respectively, for the three-month periods ended June 30, 2018 and 2017. For the six-month periods ended June 30, 2018 and 2017, the compensation cost recognized for equity compensation was \$151,000 and \$201,000, respectively. The recognized tax benefit for equity compensation expense was \$37,000 and \$73,000, respectively, for the six-month periods ended June 30, 2018 and 2017.

At June 30, 2018, the total unrecognized pre-tax compensation cost related to nonvested stock option awards was \$36,000. This amount will be recognized over the next 2.0 years and the weighted average period of recognizing these costs is expected to be 1.2 years. At June 30, 2018, the total unrecognized pre-tax compensation cost related to restricted stock awards was \$458,000. This amount will be recognized over the next 3.9 years and the weighted average period of recognizing these costs is expected to be 1.2 years.

Equity Plans Activity

Stock Options

There were no stock options awarded during the three-month and six-month periods ended June 30, 2018 and June 30, 2017. A summary of option activity under the Plans as of June 30, 2018 and changes during the period then ended is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (\$000)
<u>Options</u>				
Outstanding at January 1, 2018	97,543	\$ 11.26	3.1 years	\$ 419
Awarded	—	—	—	—
Exercised	(13,359)	9.23	—	—
Expired, forfeited or cancelled	(35,135)	15.67	—	—
Outstanding at June 30, 2018	49,049	\$ 8.65	3.9 years	\$ 353
Vested at June 30, 2018	41,913	\$ 8.54	3.5 years	\$ 306

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Non-vested at June 30, 2018	7,136	\$ 9.29	6.5 years	\$ 47
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10

Restricted Stock

There were 10,915 and 22,514 shares of restricted stock awarded during the three-month and six-month periods ended June 30, 2018, respectively. There were 9,949 and 24,982 shares of restricted stock awarded during the three-month and six-month periods ended June 30, 2017, respectively. A summary of restricted stock award activity under the 2010 Plan as of June 30, 2018 and changes during the period then ended is presented below:

	Shares	Weighted Average Award Date Fair Value
<u>Restricted Stock</u>		
Nonvested at January 1, 2018	49,053	\$ 12.27
Awarded	22,514	15.44
Less: Vested	(25,455)	10.84
Less: Expired, forfeited or cancelled	(4,655)	13.69
Nonvested at June 30, 2018	41,457	\$ 10.61

Other Equity Awards

There were no stock appreciation rights, restricted performance stock, unrestricted Company stock, or performance units awarded during the three-month or six-month month periods ended June 30, 2018 or 2017 or outstanding at June 30, 2018 or December 31, 2017.

The intrinsic value used for stock options and restricted stock awards was derived from the market price of the Company's common stock of \$15.85 as of June 30, 2018.

3. COMMITMENTS AND CONTINGENCIES

In the normal course of business there are outstanding various commitments to extend credit which are not reflected in the financial statements, including loan commitments of approximately \$21,966,000 and standby letters of credit of approximately \$121,000 at June 30, 2018 and loan commitments of approximately \$10,923,000 and standby letters of credit of approximately \$121,000 at December 31, 2017. Such commitments relate primarily to real estate construction loans, revolving lines of credit and other commercial loans. However, all such commitments will not necessarily culminate in actual extensions of credit by the Company during 2018 as some of these are expected to expire without being fully drawn upon.

Standby letters of credit are commitments issued to guarantee the performance or financial obligation of a client to a third party. These guarantees are issued primarily relating to purchases of inventory, insurance programs, performance obligations to government agencies, or as security for real estate rents by commercial clients and are typically short-term in nature. Credit risk is similar to that involved in extending loan commitments to clients and accordingly, evaluation and collateral requirements similar to those for loan commitments are used. The majority of all such commitments are collateralized. 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 June 30, 2018 or December 31, 2017.

4. EARNINGS PER SHARE COMPUTATION

Basic earnings per share is computed by dividing net income by the weighted average common shares outstanding for the period (5,843,340 and 5,919,321 shares for the three-month and six-month periods ended June 30, 2018 and 6,346,650 and 6,454,864 shares for the three-month and six-month periods ended June 30, 2017). Using the treasury stock method, diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options or restricted stock, result in the issuance of common stock. Diluted earnings per share is computed by dividing net income by the weighted average common shares outstanding for the period plus the dilutive effect of stock based awards. There were 39,574 and 38,082, respectively, dilutive shares for the three-month and six-month periods ended June 30, 2018 and 81,372 and 85,801, respectively, dilutive shares for the three-month and six-month periods ended June 30, 2017. For the three-month periods ended June 30, 2018 and 2017, there were zero and 32,448 stock options, respectively, that were excluded from the calculation as they were considered antidilutive. For the six-month periods ended June 30, 2018 and 2017, there were zero and 32,448 stock options, respectively, that were excluded from the calculation as they were considered antidilutive. Earnings per share is retroactively adjusted for stock dividends and stock splits, if applicable, for all periods presented.

5. INVESTMENT SECURITIES

The amortized cost and estimated fair values of Available-for-Sale and Held-to-Maturity investment securities at June 30, 2018 and December 31, 2017 consisted of the following (dollars in thousands):

Available-for-Sale

	June 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government Agencies and Sponsored Entities	\$260,715	\$ 634	\$ (4,890)	) \$256,459
Obligations of states and political subdivisions	15,851	153	(294)	) 15,710
Corporate bonds	6,492	84	(70)	) 6,506
U.S. Treasury securities	2,989	—	(4)	) 2,985
	\$286,047	\$ 871	\$ (5,258)	) \$281,660

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government Agencies and Sponsored Entities	\$233,956	\$ 1,184	\$ (2,271)	) \$232,869
Obligations of states and political subdivisions	22,281	528	(94)	) 22,715
Corporate bonds	6,490	160	(24)	) 6,626
Equity securities:				
Corporate stock	51	61	—	) 112
	\$262,778	\$ 1,933	\$ (2,389)	) \$262,322

Net unrealized losses on available-for-sale investment securities totaling \$4,387,000 were recorded, net of \$1,397,000 in tax liabilities, as accumulated other comprehensive loss within shareholders' equity at June 30, 2018. Proceeds and gross realized gains from the sale and call of available-for-sale investment securities for the three-month and six-month periods ended June 30, 2018 totaled \$15,942,000 and \$11,000, respectively. There were no transfers of available-for-sale investment securities for the three-month and six-month periods ended June 30, 2018.

Net unrealized losses on available-for-sale investment securities totaling \$456,000 were recorded, net of \$135,000 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2017. Proceeds and gross realized gains from the sale and call of available-for-sale investment securities for the three-month period ended June 30, 2017 totaled \$9,133,000 and \$86,000, respectively, and for the six-month period ended June 30, 2017 proceeds and gross realized gains from the sale and call of available-for-sale investment securities totaled \$17,750,000 and \$142,000, respectively. There were no transfers of available-for-sale investment securities for the three-month and six-month periods ended June 30, 2017.

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Held-to-Maturity

June 30, 2018

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government Agencies and Sponsored Entities	\$ 330	\$ 19	\$ —	\$ 349

December 31, 2017

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government Agencies and Sponsored Entities	\$ 378	\$ 26	\$ —	\$ 404

There were no sales or transfers of held-to-maturity investment securities for the periods ended June 30, 2018 and June 30, 2017. Investment securities with unrealized losses at June 30, 2018 and December 31, 2017 are summarized and classified according to the duration of the loss period as follows (dollars in thousands):

June 30, 2018

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale						
Debt securities:						
U.S. Government Agencies and Sponsored Entities	\$146,460	\$ (2,727)	59,701	(2,163)	\$206,161	\$ (4,890)
Obligations of states and political subdivisions	1,686	(89)	4,483	(205)	6,169	(294)
Corporate bonds	2,422	(70)	—	—	2,422	(70)
U.S. Treasury securities	2,985	(4)	—	—	2,985	(4)
	\$153,553	\$ (2,890)	\$64,184	\$ (2,368)	\$217,737	\$ (5,258)

December 31, 2017

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale						
Debt securities:						
US Government Agencies and Sponsored Entities	\$119,455	\$ (1,148)	\$49,258	\$ (1,123)	\$168,713	\$ (2,271)
Obligations of states and political subdivisions	1,130	(9)	4,654	(85)	5,784	(94)
Corporate bonds	1,967	(24)	—	—	1,967	(24)
	\$122,552	\$ (1,181)	\$53,912	\$ (1,208)	\$176,464	\$ (2,389)

There were no held-to-maturity investment securities with unrealized losses as of June 30, 2018 or December 31, 2017.

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At June 30, 2018, the Company held 218 securities of which 87 were in a loss position for less than twelve months and 43 were in a loss position for twelve months or more. Of the 87 securities in a loss position for less than twelve months, 80 were U.S. Government Agencies and Sponsored Entities securities, five were obligations of states or political subdivisions, and two were corporate bonds and of the 43 securities that were in a loss position for greater than twelve months, 39 were U.S. Government Agencies and Sponsored Entities securities and four was an obligation of states or political subdivisions.

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At December 31, 2017, the Company held 217 securities of which 64 were in a loss position for less than twelve months and 35 were in a loss position for twelve months or more. Of the 35 securities in a loss position for greater than twelve months at December 31, 2017, four were municipal securities and 31 were US Government Agencies and Sponsored Agencies securities.

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

The amortized cost and estimated fair values of investment securities at June 30, 2018 by contractual maturity are shown below (dollars in thousands).

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Within one year	\$2,989	\$2,985		
After one year through five years	4,629	4,570		
After five years through ten years	12,306	12,310		
After ten years	5,408	5,336		
	25,332	25,201		
Investment securities not due at a single maturity date:				
US Government Agencies and Sponsored Entities	260,715	256,459	\$ 330	\$ 349
	\$286,047	\$281,660	\$ 330	\$ 349

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.

6. IMPAIRED AND NONPERFORMING LOANS AND LEASES AND OTHER REAL ESTATE OWNED

At June 30, 2018 and December 31, 2017, the recorded investment in nonperforming loans and leases was approximately \$1,944,000 and \$1,892,000, respectively. Nonperforming loans and leases include all such loans and leases that are either placed on nonaccrual status or are 90 days past due as to principal or interest but still accrue interest because such loans are well-secured and in the process of collection. The Company considers a loan to be impaired when, based on current information and events, it is probable that it will be unable to collect all amounts due (principal and interest) according to the contractual terms of the original loan agreement. At June 30, 2018, the recorded investment in loans and leases that were considered to be impaired totaled \$11,981,000, which includes \$1,944,000 in nonaccrual loans and leases and \$10,037,000 in performing loans and leases. Of the total impaired loans of \$11,981,000, loans totaling \$6,385,000 were deemed to require no specific reserve and loans totaling \$5,596,000 were deemed to require a related valuation allowance of \$446,000. At December 31, 2017, the recorded investment in loans and leases that were considered to be impaired totaled \$13,757,000, which includes \$1,892,000 in nonaccrual loans and leases and \$11,865,000 in performing loans and leases. Of the total impaired loans of \$13,757,000, loans totaling \$7,601,000 were deemed to require no specific reserve and loans totaling \$6,156,000 were deemed to require a related valuation allowance of \$355,000.

At June 30, 2018 and December 31, 2017, the recorded investment in other real estate owned ("OREO") was \$961,000. During the first and second quarters of 2018, the Company did not add any new, impair, or sell any of the OREO properties. The June 30, 2018 and December 31, 2017 OREO balance of \$961,000 consisted of one commercial land

property.

14

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Nonperforming assets at June 30, 2018 and December 31, 2017 are summarized as follows:

(dollars in thousands)	June 30, 2018	December 31, 2017
Nonaccrual loans and leases that are current to terms (less than 30 days past due)	\$ 13	\$ 1,603
Nonaccrual loans and leases that are past due	1,931	289
Loans and leases past due 90 days and accruing interest	—	—
Other real estate owned	961	961
Total nonperforming assets	\$ 2,905	\$ 2,853

Nonperforming loans and leases to total loans and leases	0.66	%	0.60	%
Total nonperforming assets to total assets	0.43	%	0.44	%

Impaired loans and leases as of and for the periods ended June 30, 2018 and December 31, 2017 are summarized as follows:

(dollars in thousands)	As of June 30, 2018			As of December 31, 2017		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial	\$—	\$—	\$ —	\$1,598	\$2,671	\$ —
Real estate-commercial	5,990	6,223	—	5,674	5,907	—
Real estate-residential	326	413	—	329	416	—
Consumer	69	69	—	—	—	—
Subtotal	\$6,385	\$ 6,705	\$ —	\$7,601	\$ 8,994	\$ —
With an allowance recorded:						
Commercial	\$1,562	\$2,635	\$ 200	\$—	\$—	\$ —
Real estate-commercial	2,771	2,854	171	4,396	4,483	261
Real estate-multi-family	—	—	—	474	474	21
Real estate-residential	1,263	1,263	75	1,286	1,286	73
Subtotal	\$5,596	\$ 6,752	\$ 446	\$6,156	\$ 6,243	\$ 355
Total:						
Commercial	\$1,562	\$2,635	\$ 200	\$1,598	\$2,671	\$ —
Real estate-commercial	8,761	9,077	171	10,070	10,390	261
Real estate-multi-family	—	—	—	474	474	21
Real estate-residential	1,589	1,676	75	1,615	1,702	73
Consumer	69	69	—	—	—	—
	\$11,981	\$13,457	\$ 446	\$13,757	\$15,237	\$ 355

The following table presents the average balance related to impaired loans and leases for the periods indicated (dollars in thousands):

Average Recorded Investments for the three months ended June 30, 2018	Average Recorded Investments for the three months ended June 30, 2017	Average Recorded Investments for the six months ended June 30, 2018	Average Recorded Investments for the six months ended June 30, 2017
-----------------------------------------------------------------------------	-----------------------------------------------------------------------------	---------------------------------------------------------------------------	---------------------------------------------------------------------------

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Commercial	\$ 1,562	\$ 16	\$ 1,580	\$ —
Real estate-commercial	8,794	14,067	8,828	13,732
Real estate-multi-family	—	481	—	478
Real estate-residential	1,596	2,296	1,602	2,437
Agriculture	—	357	—	351
Consumer	69	—	69	—
Total	\$ 12,021	\$ 17,217	\$ 12,079	\$ 16,998

15

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The following table presents the interest income recognized on impaired loans and leases for the periods indicated (dollars in thousands):

	Interest Income Recognized for the three months ended		Interest Income Recognized for the six months ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Commercial	\$ —	\$ —	\$ —	\$ 1
Real estate-commercial	129	179	238	356
Real estate-multi-family	—	8	—	16
Real estate-residential	21	37	41	63
Agriculture	—	4	—	9
Consumer	—	—	2	—
Total	\$ 150	\$ 228	\$ 281	\$ 445

7. TROUBLED DEBT RESTRUCTURINGS

During the three and six-month periods ended June 30, 2018 and 2017, there were no loans that were modified as troubled debt restructurings. There were no payment defaults on troubled debt restructurings within 12 months following the modification for the three-month and six-month periods ended June 30, 2018, with the exception of one commercial loan with a June 30, 2018 balance of \$1,562,000. There were no payment defaults on troubled debt restructurings within 12 months following the modification for the three-month and six-month periods ended June 30, 2017. At June 30, 2018 and December 31, 2017, there were no unfunded commitments on those loans considered troubled debt restructures.

8. ALLOWANCE FOR LOAN AND LEASE LOSSES

The Company's loan and lease portfolio allocated by management's internal risk ratings as of June 30, 2018 and December 31, 2017 are summarized below:

June 30, 2018 (dollars in thousands)	Credit Risk Profile by Internally Assigned Grade				
	Real Estate				
	Commercial	Commercial	Multi-family	Construction	Residential
Grade:					
Pass	\$23,308	\$160,143	\$ 62,197	\$ 6,408	\$ 14,976
Watch	125	15,854	3,871	—	1,848
Special mention	—	1,265	—	—	—
Substandard	31	282	—	—	—
Doubtful or loss	1,562	—	—	—	—
Total	\$25,026	\$177,544	\$ 66,068	\$ 6,408	\$ 16,824

Credit Risk Profile by Internally
Assigned Grade Other Credit
Exposure

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Grade:	Leases	Agriculture	Consumer	Total
Pass	\$117	\$2,603	\$ 529	\$ 270,281
Watch	—	—	150	21,848
Special mention	—	—	1	1,266
Substandard	—	—	69	382
Doubtful or loss	—	—	—	1,562
Total	\$117	\$2,603	\$ 749	\$ 295,339

16

December 31, 2017 (dollars in thousands)	Credit Risk Profile by Internally Assigned Grade				
	Real Estate				
	Commercial	Commercial	Multi-family	Construction	Residential
Grade:					
Pass	\$23,617	\$164,815	\$ 73,644	\$ 5,863	\$ 13,767
Watch	96	18,083	4,381	—	1,507
Special mention	66	2,265	—	—	539
Substandard	—	289	—	—	—
Doubtful or loss	1,598	—	—	—	—
Total	\$25,377	\$185,452	\$ 78,025	\$ 5,863	\$ 15,813

Grade:	Credit Risk Profile by Internally Assigned Grade			Total
	Leases	Agriculture	Consumer	
Pass	\$205	\$1,713	\$ 713	\$ 284,337
Watch	—	—	155	24,222
Special mention	—	—	70	2,940
Substandard	—	—	7	296
Doubtful or loss	—	—	—	1,598
Total	\$205	\$1,713	\$ 945	\$ 313,393

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The allocation of the Company's allowance for loan and lease losses and by portfolio segment and by impairment methodology are summarized below:

June 30, 2018

(dollars in thousands)

	Real Estate				Other					
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	Unallocated	Total
<u>Allowance for Loan and Lease Losses</u>										
Beginning balance, January 1, 2018	\$447	\$2,174	\$1,047	\$269	\$205	\$—	\$31	\$14	\$291	\$4,364
Provision for loan losses	213	(78)	(208)	29	34	(1)	18	(3)	(4)	—
Loans charged-off	—	—	—	—	—	—	—	—	—	—
Recoveries	9	4	—	—	—	1	—	—	—	14
Ending balance, June 30, 2018	\$669	\$2,100	\$839	\$298	\$239	\$—	\$49	\$11	\$287	\$4,383
Ending balance:										
Individually evaluated for impairment	\$200	\$171	\$—	\$—	\$75	\$—	\$—	\$—	\$—	\$446
Ending balance:										
Collectively evaluated for impairment	\$469	\$1,929	\$839	\$298	\$164	\$—	\$49	\$11	\$287	\$4,383
Loans										
Ending balance	\$25,026	\$177,544	\$66,068	\$6,408	\$16,824	\$117	\$2,603	\$749	\$—	\$299,829
Ending balance:										
Individually evaluated for impairment	\$1,562	\$8,761	\$—	\$—	\$1,589	\$—	\$—	\$69	\$—	\$11,921
Ending balance:										
Collectively evaluated for impairment	\$23,464	\$168,783	\$66,068	\$6,408	\$15,235	\$117	\$2,603	\$680	\$—	\$287,908
<u>Allowance for Loan and Lease Losses</u>										
Beginning balance, March 31, 2018	\$546	\$2,143	\$966	\$288	\$218	\$—	\$31	\$15	\$281	\$4,379
Provision for loan losses	121	(45)	(127)	10	21	—	18	(4)	6	—
Loans charged off	—	—	—	—	—	—	—	—	—	—
Recoveries	2	2	—	—	—	—	—	—	—	4
Ending balance, June 30, 2018	\$669	\$2,100	\$839	\$298	\$239	\$—	\$49	\$11	\$287	\$4,383

18

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December 31,
2017

(dollars in
thousands)

	Real Estate				Other					Total
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	Unallocated	
Ending balance: Individually evaluated for impairment	\$ —	\$ 261	\$ 21	\$ —	\$ 73	\$ —	\$ —	\$ —	\$ —	\$ 355
Ending balance: Collectively evaluated for impairment	\$ 447	\$ 1,913	\$ 1,026	\$ 269	\$ 132	\$ —	\$ 31	\$ 14	\$ 291	\$ 4,123
Loans										
Ending balance	\$ 25,377	\$ 185,452	\$ 78,025	\$ 5,863	\$ 15,813	\$ 205	\$ 1,713	\$ 945	\$ —	\$ 313,393
Ending balance: Individually evaluated for impairment	\$ 1,598	\$ 10,070	\$ 474	\$ —	\$ 1,615	\$ —	\$ —	\$ —	\$ —	\$ 13,757
Ending balance: Collectively evaluated for impairment	\$ 23,779	\$ 175,382	\$ 77,551	\$ 5,863	\$ 14,198	\$ 205	\$ 1,713	\$ 945	\$ —	\$ 299,636

June 30, 2017

(dollars in thousands)

	Real Estate				Other					Total
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	Unallocated	
<u>Allowance for Loan and Lease Losses</u>										
Beginning balance, January 1, 2017	\$ 855	\$ 2,050	\$ 851	\$ 446	\$ 253	\$ 1	\$ 64	\$ 24	\$ 278	\$ 4,822
Provision for loan losses	58	(12)	(62)	11	15	—	(5)	(8)	3	—
Loans charged-off	—	—	—	—	—	—	—	—	—	—
Recoveries	3	53	—	—	—	—	—	3	—	59
Ending balance, June 30, 2017	\$ 916	\$ 2,091	\$ 789	\$ 457	\$ 268	\$ 1	\$ 59	\$ 19	\$ 281	\$ 4,881

Allowance for Loan and Lease Losses

Beginning balance, March 31, 2017	\$ 836	\$ 2,107	\$ 836	\$ 479	\$ 232	\$ 1	\$ 62	\$ 21	\$ 259	\$ 4,833
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Provision for loan losses	78	(60)	(47)	(22)	36	—	(3)	(4)	22	—
Loans charged off	—	—	—	—	—	—	—	—	—	—
Recoveries	2	44	—	—	—	—	—	2	—	48
Ending balance, June 30, 2017	\$ 916	\$2,091	\$ 789	\$ 457	\$ 268	\$ 1	\$ 59	\$ 19	\$ 281	\$4,881

19

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The Company's aging analysis of the loan and lease portfolio at June 30, 2018 and December 31, 2017 are summarized below:

June 30, 2018

(dollars in thousands)

	Past Due				Current	Total Loans	Past Due Greater Than 90 Days and	
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due			Accruing	Nonaccrual
Commercial:								
Commercial	\$ —	\$ 18	\$ 1,562	\$ 1,580	\$23,446	\$ 25,026	—	\$ 1,593
Real estate:								
Commercial	—	—	283	283	177,261	177,544	—	283
Multi-family	—	—	—	—	66,068	66,068	—	—
Construction	—	—	—	—	6,408	6,408	—	—
Residential	99	—	—	99	16,725	16,824	—	—
Other:								
Leases	—	—	—	—	117	117	—	—
Agriculture	—	—	—	—	2,603	2,603	—	—
Consumer	—	—	69	69	680	749	—	68
Total	\$ 99	\$ 18	\$ 1,914	\$ 2,031	\$293,308	\$ 295,339	\$ —	\$ 1,944

December 31, 2017

(dollars in thousands)

	Past Due				Current	Total Loans	Past Due Greater Than 90 Days and	
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due			Accruing	Nonaccrual
Commercial:								
Commercial	\$ —	\$ —	\$ —	\$ —	\$25,377	\$ 25,377	\$ —	\$ 1,597
Real estate:								
Commercial	—	—	289	289	185,163	185,452	—	289
Multi-family	—	—	—	—	78,025	78,025	—	—
Construction	—	—	—	—	5,863	5,863	—	—
Residential	146	—	—	146	15,667	15,813	—	—
Other:								
Leases	—	—	—	—	205	205	—	—
Agriculture	—	—	—	—	1,713	1,713	—	—
Consumer	1	—	—	1	944	945	—	6
Total	\$ 147	\$ —	\$ 289	\$ 436	\$312,957	\$ 313,393	\$ —	\$ 1,892

20

9. BORROWING ARRANGEMENTS

At June 30, 2018, the Company had \$17,000,000 of unsecured short-term borrowing arrangements with two of its correspondent banks. There were no advances under the borrowing arrangements as of June 30, 2018 or December 31, 2017.

The Company has a line of credit available with the Federal Home Loan Bank of San Francisco (the "FHLB") which is secured by pledged mortgage loans and investment securities. Borrowings may include overnight advances as well as loans with terms of up to thirty years. Advances (both short-term and long-term) totaling \$15,500,000 were outstanding from the FHLB at June 30, 2018, bearing interest rates ranging from 1.18% to 1.90% and maturing between July 20, 2018 and April 12, 2021. Advances totaling \$15,500,000 were outstanding from the FHLB at December 31, 2017, bearing interest rates ranging from 1.18% to 1.90% and maturing between July 20, 2018 and April 12, 2021. Remaining amounts available under the borrowing arrangement with the FHLB at June 30, 2018 and December 31, 2017 totaled \$108,277,000 and \$117,546,000, respectively. In addition, the Company has a secured borrowing agreement with the Federal Reserve Bank of San Francisco. The borrowing can be secured by pledging selected loans and investment securities. Borrowings generally are short-term including overnight advances as well as loans with terms up to ninety days. Amounts available under this borrowing arrangement at June 30, 2018 and December 31, 2017 were \$7,920,000 and \$9,085,000, respectively. There were no advances outstanding under this borrowing arrangement as of June 30, 2018 and December 31, 2017.

10. INCOME TAXES

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

The Company accounts for income taxes using the balance sheet method, under which deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amounts of assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

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 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, if applicable, 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. The Company recognizes accrued interest and penalties related to unrecognized tax benefits, if applicable, as a component of interest expense in the consolidated statement of income. There have been no unrecognized tax benefits or accrued interest and penalties for the three-month and six-month periods ended June 30, 2018 and 2017.

11. FAIR VALUE MEASUREMENTS

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of June 30, 2018 and December 31, 2017. They indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. In 2018, the Company adopted the provisions of Accounting Standard Update 2016-01 "*Recognition and Measurement of Financial Assets and Financial Liabilities*" ("ASU 2016-01"). ASU 2016-01 requires the Company to use the exit price notion when measuring the fair value of financial instruments. The Company used the exit price notion for valuing financial instruments in 2018 and the entry price notion for valuing financial instruments in 2017. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

Estimated fair values are disclosed for financial instruments for which it is practicable to estimate fair value. These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

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

	Carrying Amount	Fair Value Measurements Using:			Total
		Level 1	Level 2	Level 3	
June 30, 2018					
Financial assets:					
Cash and due from banks	\$45,068	\$45,068	\$—	\$—	\$45,068
Federal funds sold	8,000	8,000	—	—	8,000
Interest-bearing deposits in banks	1,746	—	1,746	—	1,746
Available-for-sale securities	281,660	2,985	278,675	—	281,660
Held-to-maturity securities	330	—	349	—	349
FHLB stock	3,932	N/A	N/A	N/A	N/A
Net loans and leases:	290,552	—	—	298,480	298,480
Accrued interest receivable	1,873	—	1,067	806	1,873
Financial liabilities:					
Deposits:					

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Noninterest-bearing	\$221,402	\$221,402	\$—	\$—	\$221,402
Savings	70,184	70,184	—	—	70,184
Money market	145,801	145,901	—	—	145,901
Interest checking	66,729	66,729	—	—	66,729
Time Deposits	77,200	—	77,038	—	77,038
Short-term borrowings	6,500	6,500	—	—	6,500
Long-term borrowings	9,000	—	8,980	—	8,980
Accrued interest payable	65	7	58	—	65

22

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December 31, 2017	Carrying Amount	Fair Value Measurements Using:			Total
		Level 1	Level 2	Level 3	
Financial assets:					
Cash and due from banks	\$38,467	\$38,467	\$—	\$—	\$38,467
Interest-bearing deposits in banks	1,746	—	1,750	—	1,750
Available-for-sale securities	262,322	66	262,256	—	262,322
Held-to-maturity securities	378	—	404	—	404
FHLB stock	3,932	N/A	N/A	N/A	N/A
Net loans and leases:	308,713	—	—	317,900	317,900
Accrued interest receivable	1,956	—	1,124	832	1,956
Financial liabilities:					
Deposits:					
Noninterest-bearing	\$215,528	\$215,528	\$—	\$—	\$215,528
Savings	66,130	66,130	—	—	66,130
Money market	130,032	130,032	—	—	130,032
Interest checking	64,709	64,709	—	—	64,709
Time Deposits	79,681	—	79,614	—	79,614
Short-term borrowings	3,500	3,500	—	—	3,500
Long-term borrowings	12,000	—	11,978	—	11,978
Accrued interest payable	65	4	61	—	65

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 by the Company to estimate the fair values of its financial instruments at December 31, 2017:

Cash and due from banks: The carrying amounts of cash and short-term instruments, including Federal funds sold, approximate fair values and are classified as Level 1.

Interest-bearing deposits in banks: The fair values of interest-bearing deposits in banks are estimated by discounting their future cash flows using rates at each reporting date for instruments with similar remaining maturities offered by comparable financial institutions and are classified as Level 2.

Investment securities: For investment securities, fair values are based on quoted market prices, where available, and are classified as Level 1. If quoted market prices are not available, fair values are estimated using quoted market prices for similar securities and indications of value provided by brokers and are classified as Level 2.

FHLB stock: It is not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability.

Loans and leases: Fair values of loans, excluding loans held for sale, are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting

in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality also resulting in a Level 3 classification.

Deposits: The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 1 classification. For time deposits, the fair values for fixed rate certificates of deposit are estimated using a discounted cash flow methodology that applies market interest rates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Short-term and long-term borrowings: The fair value of short-term borrowings is estimated to be the carrying amount and is classified as Level 1. The fair value of long-term borrowings is estimated using a discounted cash flow analysis using interest rates currently available for similar debt instruments and are classified as Level 2.

Accrued interest receivable and payable: The carrying amount of accrued interest receivable approximates fair value resulting in a Level 3 classification and the carrying amount of accrued interest payable approximates fair value resulting in a Level 2 classification.

Off-balance sheet instruments: Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments was not material at December 31, 2017.

Assets and liabilities measured at fair value on a recurring and non-recurring basis along with any related gain or loss recognized in the income statement due to fair value changes are presented in the following table:

Description (dollars in thousands)	Fair Value	Fair Value Measurements Using			Total Gains (Losses)
		Level 1	Level 2	Level 3	
June 30, 2018					
Assets and liabilities measured on a recurring basis:					
Available-for-sale securities:					
US Government Agencies and Sponsored Entities	\$256,459	\$—	\$256,459	\$—	\$ —
Obligations of states and political subdivisions	15,710	—	15,710	—	—
Corporate bonds	6,506	—	6,506	—	—
U.S. Treasury bonds	2,985	2,985	—	—	—
Total recurring	\$281,660	\$2,985	\$278,675	\$—	\$ —
Assets and liabilities measured on a nonrecurring basis:					
Impaired loans:					
Real estate:					
Commercial	\$1,362	\$—	\$—	\$1,362	\$ —
Total nonrecurring	\$1,362	\$—	\$—	\$1,362	\$ —

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Description (dollars in thousands)	Fair Value	Fair Value Measurements Using			Total Gains (Losses)
		Level 1	Level 2	Level 3	
December 31, 2017					
Assets and liabilities measured on a recurring basis:					
Available-for-sale securities:					
US Government Agencies and Sponsored Agencies	\$232,869	\$—	\$232,869	\$—	\$—
Corporate Debt securities	6,626	—	6,626	—	—
Obligations of states and political subdivisions	22,715	—	22,715	—	—
Corporate stock	112	66	46	—	—
Total recurring	\$262,322	\$66	\$262,256	\$—	\$—
Assets and liabilities measured on a nonrecurring basis:					
Impaired loans:					
Commercial	\$1,598	\$—	\$—	\$1,598	\$(1,073)
Real estate:					
Commercial	178	—	—	178	—
Residential	329	—	—	329	—
Other real estate owned					
Land	961	—	—	961	—
Total nonrecurring	\$3,066	\$—	\$—	\$3,066	\$(1,073)

There were no significant transfers between Levels 1 and 2 during the three-month and six-month periods ended June 30, 2018 or the twelve months ended December 31, 2017.

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

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

Impaired loans – The fair value of collateral dependent impaired loans adjusted for specific allocations of the allowance for loan losses is generally based on recent real estate appraisals and/or evaluations. These appraisals and/or evaluations may utilize a single valuation approach or a combination of approaches including comparable sales, cost and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income and other available data. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. The valuation technique used for all Level 3 nonrecurring impaired loans is the sales comparison approach less a reserve for past dues taxes and selling costs ranging from 8% to 10%.

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

12. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board (the “FASB”) and the International Accounting Standards Board (the “IASB”) jointly issued a comprehensive new revenue recognition standard that will supersede nearly all existing revenue recognition guidance under GAAP and International Financial Reporting Standards (“IFRS”). Previous revenue recognition guidance in GAAP consisted of broad revenue recognition concepts together with numerous revenue requirements for particular industries or transactions, which sometimes resulted in different accounting for economically similar transactions. In contrast, IFRS provided limited revenue recognition guidance and, consequently, could be difficult to apply to complex transactions. Accordingly, the FASB and the IASB initiated a joint project to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRS that would: (1) remove inconsistencies and weaknesses in revenue requirements; (2) provide a more robust framework for addressing revenue issues; (3) improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; (4) provide more useful information to users of financial statements through improved disclosure requirements; and (5) simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. To meet those objectives, the FASB issued Accounting Standards Update (“ASU”) No. 2014-09, “*Revenue from Contracts with Customers*.” The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies generally will be required to use more judgment and make more estimates than under current guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The standard was initially effective for public entities for interim and annual reporting periods beginning after December 15, 2016; early adoption was not permitted. However, in August 2015, the FASB issued ASU No. 2015-14, “*Revenue from Contracts with Customers - Deferral of the Effective Date*” which deferred the effective date by one year (i.e., interim and annual reporting periods beginning after December 15, 2017). For financial reporting purposes, the standard allows for either full retrospective adoption, meaning the standard is applied to all of the periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements with the cumulative effect of initially applying the standard recognized at the date of initial application. In addition, the FASB has begun to issue targeted updates to clarify specific implementation issues of ASU 2014-09. These updates include ASU No. 2016-08, “*Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*,” ASU No. 2016-10, “*Identifying Performance Obligations and Licensing*,” ASU No. 2016-12, “*Narrow-Scope Improvements and Practical Expedients*,” and ASU No. 2016-20 “*Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*.” The Company has assessed its revenue streams and reviewed its contracts that could potentially be affected by the ASU including deposit related fees, interchange fees, and merchant income, to determine the potential impact the new guidance is expected to have on the Company’s financial position, results of operations or cash flows. The Company adopted ASU No. 2014-09 on January 1, 2018. The effects of adopting ASU No. 2014-09 did not change the amounts of revenue recorded for the Company’s in-scope revenue streams.

In January 2016, the FASB issued ASU No. 2016-01, “*Recognition and Measurement of Financial Assets and Financial Liabilities*.” This ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments by making targeted improvements to GAAP as follows: (1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; (2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment

exists, an entity is required to measure the investment at fair value; (3) eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (4) eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (5) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (6) require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (7) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (8) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. ASU No. 2016-01 is effective for interim and annual reporting periods beginning after December 15, 2017. Early application was permitted as of the beginning of the fiscal year of adoption only for provisions (3) and (6) above. Early adoption of the other provisions mentioned above were not permitted. The Company adopted ASU No. 2016-01 on January 1, 2018. The effects of adopting ASU No. 2016-01 resulted in the Company using the exit price notion for valuing financial instruments in 2018, but did not have a material impact on the Company's financial position, results of operations or cash flows.

In February 2016, the FASB issued ASU No. 2016-02, “*Leases*.” Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases): 1) a lease liability, which is the present value of a lessee’s obligation to make lease payments, and 2) a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Lessor accounting under the new guidance remains largely unchanged as it is substantially equivalent to existing guidance for sales-type leases, direct financing leases, and operating leases. Leveraged leases have been eliminated, although lessors can continue to account for existing leveraged leases using the current accounting guidance. Other limited changes were made to align lessor accounting with the lessee accounting model and the new revenue recognition standard. All entities will classify leases to determine how to recognize lease-related revenue and expense. Quantitative and qualitative disclosures will be required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The intention is to require enough information to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an entity’s leasing activities. ASU No. 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. All entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. They have the option to use certain relief; full retrospective application is prohibited. The Company is currently evaluating the provisions of ASU No. 2016-02. Based on the initial evaluation of the Company’s current lease obligations, the Company has determined that the provisions of ASU No. 2016-02 may result in an increase in assets to recognize the present value of the lease obligations with a corresponding increase in liabilities, however, the Company does not expect this to have a material impact on the Company’s financial position, results of operations or cash flows.

In June 2016, the FASB issued ASU No. 2016-13, “*Measurement of Credit Losses on Financial Instruments*.” This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren’t measured at fair value through net income. In issuing the standard, the FASB is responding to criticism that today’s guidance delays recognition of credit losses. The standard will replace today’s “incurred loss” approach with an “expected loss” model. The new model, referred to as the current expected credit loss (“CECL”) model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for-sale (“AFS”) debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. The ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity’s assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU No. 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted for interim and annual reporting periods beginning after December 15, 2018. Entities will apply the standard’s provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). While the Company is currently evaluating the provisions of ASU No. 2016-13 to determine the potential impact the new standard will have on the Company’s Consolidated Financial Statements, it has taken steps to prepare for the implementation when it becomes effective, such as forming an internal task force, gathering pertinent data, consulting with outside professionals, evaluating its current IT systems, and purchasing a software solution.

13. REVENUE FROM CONTRACTS WITH CUSTOMERS

On January 1, 2018 the Company adopted ASC Topic 606, as revised under ASU's 2014-09, 2014-08 and 2016-20, using the modified retrospective method as of January 1, 2018. Other income disclosures for periods beginning after January 1, 2018 are presented under revised ASC Topic 606, which have not materially changed from the prior year amounts. Consistent with Topic 606, noninterest income covered by this guidance is recognized as services are transferred to our customers in an amount that reflects the consideration we expect to be entitled to in exchange for those services.

Deposit Service Charges — Deposit service charges primarily consist of fees earned from our treasury management services. These services include bill pay, ACH, positive pay, lockbox, remote deposit capture, online banking and cash vault, among others. Customers are given the option to pay for these services in cash or by offsetting the fees for these services against an earnings credit that is given for maintaining noninterest-bearing deposits. The Company's performance obligations on its treasury services are satisfied either at the time of the transaction or over the course of a month. Most customers pay deposit charges on a monthly basis.

Merchant and Bankcard Fees — The Company earns various types of network transaction fees from third party payment network providers which consist of (i) interchange fees earned from the payment network as a debit card issuer and (ii) ongoing merchant fees earned by the Company for referring our clients to the payment processing provider which allows our clients to accept credit cards as a form of payment. The Company is an issuer of debit cards only as it relates to Merchant and Bankcard fees. Interchange income, which is settled on a daily basis, is recognized as settlement occurs. Chargebacks have not historically been, nor are they expected to be significant to the overall fee revenue and will be recognized upon occurrence. Referral and merchant fees are recognized when the transaction occurs.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The following is management’s discussion and analysis of the significant changes in American River Bankshares’ (the “Company”) balance sheet accounts between December 31, 2017 and June 30, 2018 and its income and expense accounts for the three-month and six-month periods ended June 30, 2018 and 2017. The discussion is designed to provide a better understanding of significant trends related to the Company’s financial condition, results of operations, liquidity, capital resources and interest rate sensitivity. This discussion and supporting tables and the consolidated financial statements and related notes appearing elsewhere in this report are unaudited. Interest income and net interest income are presented on a fully taxable equivalent basis (FTE) within management’s discussion and analysis. Certain matters discussed or incorporated by reference in this Quarterly Report on Form 10-Q including, but not limited to, matters described in “this Item 2 - Management’s Discussion and Analysis of Financial Condition and Results of Operations,” are “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, Section 27A of the Securities Act of 1933, as amended, and subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements may contain words related to future projections including, but not limited to, words such as “believe,” “expect,” “anticipate,” “intend,” “may,” “will,” “should,” “could,” “would,” and variations of those words and similar words that are subject to risks, uncertainties and other factors that could cause actual results to differ significantly from those projected. Factors that could cause or contribute to such differences include, but are not limited to, the following:

- legislation promulgated by the United States Congress and actions taken by governmental agencies that may impact the U.S. financial system;
- the risks presented by economic volatility and recession, which could adversely affect credit quality, collateral values, including real estate collateral, investment values, liquidity and loan originations and loan portfolio delinquency rates;
- variances in the actual versus projected growth in assets and return on assets;
- potential loan and lease losses;
- potential expenses associated with resolving nonperforming assets as well as regulatory changes;
- changes in the interest rate environment including interest rates charged on loans, earned on securities investments and paid on deposits and other borrowed funds;
- competitive effects;
- potential declines in fee and other noninterest income earned associated with economic factors, as well as regulatory changes;
- general economic conditions nationally, regionally, and within our operating markets could be less favorable than expected or could have a more direct and pronounced effect on us than expected and adversely affect our ability to continue internal growth at historical rates and maintain the quality of our earning assets;
- changes in the regulatory environment including increased capital and regulatory compliance requirements and government intervention in the U.S. financial system;
- changes in business conditions and inflation;
- changes in securities markets, public debt markets, and other capital markets;
 - potential data processing, cybersecurity and other operational systems failures, breach or fraud;
- potential decline in real estate values in our operating markets;
- the effects of uncontrollable events such as terrorism, the threat of terrorism or the impact of military conflicts in connection with the conduct of the war on terrorism by the United States and its allies, natural disasters (including earthquakes and wildfires), and disruption of power supplies and communications;
- changes in accounting standards, tax laws or regulations and interpretations of such standards, laws or regulations;
- projected business increases following any future strategic expansion could be lower than expected;
- the goodwill we have recorded in connection with acquisitions could become impaired, which may have an adverse impact on our earnings;
- our ability to comply with any regulatory orders or requirements we may become subject to;

- the effects and costs of litigation and other legal developments;
- the reputation of the financial services industry could experience deterioration, which could adversely affect our ability to access markets for funding and to acquire and retain customers; and
- the efficiencies we may expect to receive from any investments in personnel and infrastructure may not be realized.

The factors set forth under “Item 1A - Risk Factors” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017, and other cautionary statements and information set forth in this Quarterly Report on Form 10-Q should be carefully considered and understood as being applicable to all related forward-looking statements contained in this Quarterly Report on Form 10-Q, when evaluating the business prospects of the Company and its subsidiaries.

Forward-looking statements are not guarantees of performance. By their nature, they involve risks, uncertainties and assumptions. The future results and shareholder values may differ significantly from those expressed in these forward-looking statements. You are cautioned not to put undue reliance on any forward-looking statement. Any such statement speaks only as of the date of this report, and in the case of any documents that may be incorporated by reference, as of the date of those documents. We do not undertake any obligation to update or release any revisions to any forward-looking statements, to report any new information, future event or other circumstances after the date of this report or to reflect the occurrence of unanticipated events, except as required by law. However, your attention is directed to any further disclosures made on related subjects in our subsequent reports filed with the Securities and Exchange Commission (the “SEC”) on Forms 10-K, 10-Q and 8-K.

Use of Non-GAAP Financial Measures

This Quarterly Report on Form 10-Q (“Form 10Q”) contains certain non-GAAP (Generally Accepted Accounting Principles) financial measures in addition to results presented in accordance with GAAP. These measures include tangible book value and taxable equivalent basis. Management has presented these non-GAAP financial measures in this Form 10Q because it believes that they provide useful and comparative information to assess trends in the Company’s financial position reflected in the current quarter and year-to-date results and facilitate comparison of our performance with the performance of our peers.

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

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

Tangible Equity (non-GAAP financial measures)

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

Critical Accounting Policies

General

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The financial information contained within our statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of our transactions would be the same, the timing of events that would impact our transactions could change.

Allowance for Loan and Lease Losses

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

The allowance for loan and lease losses is determined based upon estimates that can and do change when the actual risk, loss events, or changes in other factors, occur. The analysis of the allowance uses an historical loss view as an indicator of future losses and as a result could differ from the actual losses incurred in the future. If the allowance for loan and lease losses falls below that deemed adequate (by reason of loan and lease growth, actual losses, the effect of changes in risk factors, or some combination of these), the Company has a strategy for supplementing the allowance for loan and lease losses, over the short-term. For further information regarding our allowance for loan and lease losses, see “Allowance for Loan and Lease Losses Activity” discussion later in this Item 2.

Stock-Based Compensation

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

General Development of Business

The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was incorporated under the laws of the State of California in 1995. As a bank holding company, the Company is authorized to engage in the activities permitted under the Bank Holding Company Act of 1956, as amended, and regulations thereunder. Its principal office is located at 3100 Zinfandel Drive, Suite 450, Rancho Cordova, California 95670 and its telephone number is (916) 854-0123. The Company employed an equivalent of 100 full-time employees as of June 30, 2018.

The Company owns 100% of the issued and outstanding common shares of its banking subsidiary, American River Bank (the “Bank”), and American River Financial, a California corporation which has been inactive since its incorporation in 2003.

American River Bank was incorporated and commenced business in Fair Oaks, California, in 1983 and thereafter moved its headquarters to Sacramento, California in 1985. American River Bank operates five full service offices in Sacramento and Placer Counties including the main office located at 1545 River Park Drive, Suite 107, Sacramento and branch offices in Sacramento, Gold River, and Roseville; two full service offices in Sonoma County in Healdsburg and Santa Rosa; and three full service offices in Amador County in Jackson, Pioneer, and Ione.

In 2000, the Company acquired North Coast Bank as a separate bank subsidiary. North Coast Bank was incorporated and commenced business in 1990 as Windsor Oaks National Bank in Windsor, California. In 1997, the name was changed to North Coast Bank. Effective December 31, 2003, North Coast Bank was merged with and into American River Bank. On December 3, 2004, the Company acquired Bank of Amador located in Jackson, California. Bank of Amador was merged with and into American River Bank.

The Bank’s deposits are insured by the Federal Deposit Insurance Corporation (the “FDIC”) up to applicable legal limits. On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). On November 9, 2010, the FDIC implemented a final rule to permanently increase the maximum insurance limit to \$250,000 per depositor under the Dodd-Frank Act.

American River Bank does not offer trust services or international banking services and does not plan to do so in the near future. American River Bank's primary business is serving the commercial banking needs of small to mid-sized businesses within those counties listed above. American River Bank accepts checking and savings deposits, offers money market deposit accounts and certificates of deposit, makes secured and unsecured commercial, secured real estate, and other installment and term loans and offers other customary banking services. American River Bank also conducts lease financing for certain types of business equipment. American River Bank owns 100% of two inactive companies, ARBCO and American River Mortgage. ARBCO was formed in 1984 to conduct real estate development and has been inactive since 1995. American River Mortgage has been inactive since its formation in 1994. During 2018 and 2017, the Company conducted no significant activities other than holding the shares of its subsidiaries. However, it is authorized, with the prior approval of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"), the Company's principal regulator, to engage in a variety of activities which are deemed closely related to the business of banking. The common stock of the Company is registered under the Securities Exchange Act of 1934, as amended, and is listed and traded on the Nasdaq Global Select Market under the symbol "AMRB."

Overview

The Company recorded net income of \$1,269,000 for the quarter ended June 30, 2018, which was a decrease of \$28,000 compared to \$1,297,000 reported for the same period of 2017. Diluted earnings per share for the second quarter of 2018 were \$0.22 compared to \$0.20 recorded in the second quarter of 2017. The return on average equity (“ROAE”) and the return on average assets (“ROAA”) for the second quarter of 2018 were 7.09% and 0.75%, respectively, as compared to 6.35% and 0.80%, respectively, for the same period in 2017.

Net income for the six months ended June 30, 2018 and 2017 was \$2,622,000 and \$2,481,000, respectively, with diluted earnings per share of \$0.44 in 2018 and \$0.38 in 2017. For the first six months of 2018, ROAE was 7.24% and ROAA was 0.77% compared to 6.05% and 0.77%, respectively, for the same period in 2017.

Total assets of the Company increased by \$19,634,000, or 3.0%, from \$655,622,000 at December 31, 2017 to \$675,256,000 at June 30, 2018. Net loans totaled \$290,552,000 at June 30, 2018, a decrease of \$18,161,000 or (5.9%) from \$308,713,000 at December 31, 2017. Deposit balances at June 30, 2018 totaled \$581,316,000, an increase of \$25,236,000, or 4.5%, from the \$556,080,000 at December 31, 2017.

The Company ended the second quarter of 2018 with a leverage capital ratio of 8.8%, a Tier 1 capital ratio of 17.6%, and a total risk-based capital ratio of 18.8% compared to 9.5%, 18.1%, and 19.3%, respectively, at December 31, 2017. Table One below provides a summary of the components of net income for the periods indicated (See the “Results of Operations” section that follows for an explanation of the fluctuations in the individual components).

Table One: Components of Net Income

(dollars in thousands)	For the three months ended		For the six months ended	
	June 30, 2018	2017	June 30, 2018	2017
Interest income*	\$5,553	\$5,222	\$10,678	\$10,373
Interest expense	(378)	(252)	(707)	(494)
Net interest income*	5,175	4,970	9,971	9,879
Provision for loan and lease losses	—	—	—	—
Noninterest income	380	439	752	858
Noninterest expense	(3,828)	(3,368)	(7,178)	(6,798)
Provision for income taxes	(403)	(643)	(809)	(1,259)
Tax equivalent adjustment	(55)	(101)	(114)	(199)
Net income	\$1,269	\$1,297	\$2,622	\$2,481
Average total assets	\$681,932	\$647,381	\$683,155	\$650,058
Net income (annualized) as a percentage of average total assets	0.75 %	0.80 %	0.77 %	0.77 %

* Fully taxable equivalent basis (FTE)

32

Results of Operations

Net Interest Income and Net Interest Margin

Net interest income represents the excess of interest and fees earned on interest earning assets (loans and leases, securities, Federal funds sold and investments in time deposits) over the interest paid on interest-bearing deposits and borrowed funds. Net interest margin is net interest income expressed as a percentage of average earning assets. The Company's net interest margin was 3.36% for the three months ended June 30, 2018, 3.41% for the three months ended June 30, 2017, 3.32% for the six months ended June 30, 2018 and 3.43% for the six months ended June 30, 2017.

The total fully taxable equivalent interest income component for the second quarter of 2018 increased \$331,000, or 6.3%, to \$5,553,000 compared to \$5,222,000 for the three months ended June 30, 2017. The increase in the fully taxable equivalent interest income for the second quarter of 2018 compared to the same period in 2017 is broken down by rate (up \$346,000) and volume (down \$15,000). The yield on earning assets increased from 3.59% during the second quarter of 2017 to 3.60% during the second quarter of 2018. The primary driver in this rate increase was an increase in the yield on loans which increased from 4.61% in the second quarter of 2017 to 4.79% in the second quarter of 2018 and an increase in yields on the investment portfolio which increased from 2.38% in the second quarter of 2017 to 2.51% in the second quarter of 2018. The increased yield in 2018 compared to 2017 was due to the overall higher interest rate environment. Despite the increased yield earned on the loans and investments the yield on earning assets increased just 0.01% from 3.59% to 3.60%. The increase in yield from the loans and investments was partially offset by an increase in the balances of Federal funds sold. Federal funds sold balances increased from zero in the second quarter of 2017 to an average balance of \$22,209,000 in the second quarter of 2018. However, the yield on these lower earning Federal fund balances was 1.77%, thus reducing the overall yield on earning assets.

The volume decrease of \$15,000 was primarily from a decrease in loans (\$134,000), partially offset by an increase in investment balances (\$118,000). Average loans balances decreased \$11,691,000, or (3.7%), from \$316,423,000 during the second quarter of 2017 to \$304,732,000 during the second quarter of 2018 and the average investment balances increased \$23,395,000, or 8.8%, from \$266,109,000 during the second quarter of 2017 to \$289,504,000 during the second quarter of 2018.

The total fully taxable equivalent interest income for the six months ended June 30, 2018 increased \$305,000, 2.9%, to \$10,678,000 compared to \$10,373,000 for the six months ended June 30, 2017. The breakdown of the fully taxable equivalent interest income for the six months ended June 30, 2018 over the same period in 2017 resulted from a increase in rate (up \$408,000) and a decrease in volume (down \$103,000). The primary driver in this rate increase was an increase in the yield on loans which increased from 4.59% in 2017 to 4.69% in 2018 and an increase in yields on the investment portfolio which increased from 2.40% in 2017 to 2.45% in 2018. The increased yield in 2018 compared to 2017 was due to the overall higher interest rate environment. Despite the increased yield earned on the loans and investments the yield on earning assets decreased from 3.60% in 2017 to 3.56% in 2018. The increase in yield from the loans and investments was partially offset by an increase in the balances of Federal funds sold. Federal funds sold balances increased from zero in the first six months of 2017 to an average balance of \$17,994,000 in the first six months of 2018. The yield on these lower earning Federal fund balances was 1.66%, thus reducing the overall yield on earning assets.

Interest expense was \$126,000, or 50.0%, higher in the second quarter of 2018 versus the prior year period, increasing from \$252,000 to \$378,000. The \$126,000 increase in interest expense during the second quarter of 2018 compared to the second quarter of 2017 was due to higher rates (up \$125,000) and higher volume (up \$1,000). The increase in interest expense can be attributed to an increase in rates paid on deposit and borrowing balances during a higher interest rate environment. Rates paid on interest bearing liabilities increased 11 basis points from 0.28% to 0.39% for the second quarter of 2017 compared to the same period in 2018. The largest increase due to rates occurred in the time deposits. Some of these time deposits are indexed to the three- or six-month treasury rates which have increased over

the past twelve months. Interest expense on time deposits increased by \$79,000, or 48.8%, from \$162,000 in the second quarter of 2017 to \$241,000 in the second quarter of 2018 while the average time deposit balances decreased by \$2,439,000, or (3.0%), from \$81,643,000 in the second quarter of 2017 to \$79,204,000 in the second quarter of 2018.

Interest expense was \$213,000, or 43.1% higher, in the six-month period ended June 30, 2018 increasing from \$494,000 in 2017 to \$707,000 in 2018. The increase is related to rates (up \$213,000). Rates paid on interest bearing liabilities increased 9 basis points from 0.28% to 0.37% for the first six months of 2017 compared to the first six months of 2018. Of the \$213,000 increase in interest expense, \$146,000 is related to higher rates paid on time deposit balances. Some of these time deposits are indexed to the three- or six-month treasury rates which have increased over the past twelve months. Net interest expense on time deposits increased by \$136,000, or 42.9%, from \$317,000 in 2017 to \$453,000 in 2018 while the average time deposit balances decreased by \$2,524,000, or 3.1%, from \$81,971,000 in 2017 to \$79,447,000 in 2018.

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

Table Two: Analysis of Net Interest Margin on Earning Assets

Three Months Ended June 30, (Taxable Equivalent Basis) (dollars in thousands)	2018			2017				
	Avg Balance	Interest	Avg Yield (4)	Avg Balance	Interest	Avg Yield (4)		
Assets								
Earning assets:								
Taxable loans and leases (1)	\$290,933	\$3,483	4.80	% \$302,062	\$3,458	4.59	%	
Tax-exempt loans and leases (2)	13,799	153	4.45	% 14,361	180	5.03	%	
Taxable investment securities	268,731	1,637	2.44	% 243,199	1,363	2.25	%	
Tax-exempt investment securities (2)	20,773	175	3.38	% 22,811	212	3.73	%	
Corporate stock (2)	—	—	—	99	6	24.31	%	
Federal funds sold	22,209	98	1.77	% —	—	—		
Investments in time deposits	1,741	7	1.61	% 1,259	3	0.96	%	
Total earning assets	618,186	5,553	3.60	% 583,791	5,222	3.59	%	
Cash & due from banks	29,703			29,263				
Other assets	38,533			39,191				
Allowance for loan & lease losses	(4,490)			(4,864)				
	\$681,932			\$647,381				
Liabilities & Shareholders' Equity								
Interest bearing liabilities:								
Interest checking and money market	\$227,094	76	0.13	% \$201,166	36	0.07	%	
Savings	70,129	7	0.04	% 63,467	5	0.03	%	
Time deposits	79,204	241	1.22	% 81,643	162	0.80	%	
Other borrowings	15,500	54	1.40	% 15,500	49	1.27	%	
Total interest bearing liabilities	391,927	378	0.39	% 361,776	252	0.28	%	
Noninterest bearing demand deposits	212,305			196,549				
Other liabilities	5,910			7,195				
Total liabilities	610,142			565,520				
Shareholders' equity	71,790			81,861				
	\$681,932			\$647,381				
Net interest income & margin (3)		\$5,175	3.36	%	\$4,970	3.41	%	

(1) Loan interest includes loan fees of \$243,000 and \$43,000, respectively, during the three months ended June 30, 2018 and June 30, 2017. Average loan balances include nonperforming loans.

(2) Includes taxable-equivalent adjustments that primarily relate to income on certain securities that is exempt from federal income taxes. The effective federal statutory tax rate was 21% for 2018 and 34% for 2017.

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

(4) Average yield is calculated based on actual days in the period (91 days) and annualized to actual days in the year (365 days).

34

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Six Months Ended June 30, (Taxable Equivalent Basis) (dollars in thousands)	2018			2017				
	Avg Balance	Interest	Avg Yield (4)	Avg Balance	Interest	Avg Yield (4)		
Assets								
Earning assets:								
Taxable loans and leases (1)	\$292,113	\$6,811	4.70	% \$303,834	\$6,888	4.57	%	
Tax-exempt loans and leases (2)	13,879	306	4.45	% 14,424	356	4.98	%	
Taxable investment securities	257,145	3,028	2.37	% 239,207	2,686	2.26	%	
Tax-exempt investment securities (2)	22,166	372	3.38	% 22,768	422	3.74	%	
Corporate stock (2)	—	—	—	103	16	31.33	%	
Federal funds sold	17,994	148	1.66	% —	—	—		
Interest-bearing deposits in banks	1,743	13	1.50	% 1,189	5	0.85	%	
Total earning assets	605,040	10,678	3.56	% 581,525	10,373	3.60	%	
Cash & due from banks	43,262			34,261				
Other assets	39,341			39,118				
Allowance for loan & lease losses	(4,488)			(4,846)				
	\$683,155			\$650,058				
Liabilities & Shareholders' Equity								
Interest-bearing liabilities:								
Interest checking and money market	\$223,317	133	0.12	% \$198,794	70	0.07	%	
Savings	69,872	13	0.04	% 63,367	10	0.03	%	
Time deposits	79,447	453	1.15	% 81,971	317	0.78	%	
Other borrowings	15,500	108	1.41	% 15,500	97	1.26	%	
Total interest-bearing liabilities	388,136	707	0.37	% 359,632	494	0.28	%	
Noninterest-bearing demand deposits	214,930			200,086				
Other liabilities	7,078			7,597				
Total liabilities	610,144			567,315				
Shareholders' equity	73,011			82,743				
	\$683,155			\$650,058				
Net interest income & margin (3)		\$9,971	3.32	%	\$9,879	3.43	%	

(1) Loan interest includes loan fees of \$374,000 and \$110,000, respectively, during the six months ended June 30, 2018 and June 30, 2017. Average loan balances include nonperforming loans.

(2) Includes taxable-equivalent adjustments that primarily relate to income on certain securities that is exempt from federal income taxes. The effective federal statutory tax rate was 21% for 2018 and 34% for 2017.

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

(4) Average yield is calculated based on actual days in the period (181 days) and annualized to actual days in the year (365 days).

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

Three Months Ended June 30, 2018 over 2017 (dollars in thousands)

Increase (decrease) due to change in:

Interest-earning assets:	Volume	Rate (4)	Net Change
Taxable loans and leases (1)	\$ (127)	\$152	\$ 25
Tax-exempt loans and leases (2)	(7)	(20)	(27)
Taxable investment securities	143	131	274
Tax exempt investment securities (3)	(19)	(18)	(37)
Corporate stock	(6)	—	(6)
Federal funds sold	—	98	98
Interest-bearing deposits in banks	1	3	4
Total	(15)	346	331
Interest-bearing liabilities:			
Interest checking and money market	5	35	40
Savings deposits	1	1	2
Time deposits	(5)	84	79
Other borrowings	—	5	5
Total	1	125	126
Interest differential	\$ (16)	\$221	\$ 205

Six Months Ended June 30, 2018 over 2017 (dollars in thousands)

Increase (decrease) due to change in:

Interest-earning assets:	Volume	Rate (4)	Net Change
Taxable loans and leases (1)	\$ (266)	\$189	\$ (77)
Tax-exempt loans and leases (2)	(13)	(37)	(50)
Taxable investment securities	201	141	342
Tax exempt investment securities (3)	(11)	(39)	(50)
Corporate stock	(16)	—	(16)
Federal funds sold	—	148	148
Interest-bearing deposits in banks	2	6	8
Total	(103)	408	305
Interest-bearing liabilities:			
Interest checking and money market	9	54	63
Savings deposits	1	2	3
Time deposits	(10)	146	136
Other borrowings	—	11	11

Total	—	213	213
Interest differential	\$ (103)	\$ 195	\$ 92

(1) The average balance of non-accruing loans is immaterial as a percentage of total loans and, as such, has been included in net loans.

Loan fees of \$243,000 and \$43,000, respectively, during the three months ended June 30, 2018 and June 30, 2017, (2) and loan fees of \$374,000 and \$110,000, respectively, during the six months ended June 30, 2018 and June 30, 2017, have been included in the interest income computation.

(3) Includes taxable-equivalent adjustments that primarily relate to income on certain securities that is exempt from federal income taxes. The effective federal statutory tax rate was 21% for 2018 and 34% for 2017.

(4) The rate/volume variance has been included in the rate variance.

Provision for Loan and Lease Losses

The Company did not provide any provision for loan and lease losses for the second quarter of 2018 or 2017. The Company experienced net loan and lease recoveries of \$4,000 or 0.01% (on an annualized basis) of average loans and leases for the three months ended June 30, 2018 compared to net loan and lease recoveries of \$48,000 or 0.06% (on an annualized basis) of average loans and leases for the three months ended June 30, 2017. For the first six months of 2018 and 2017, the Company did not make any provisions for loan and lease losses and net loan and lease recoveries were \$14,000 or 0.01% (on an annualized basis) of average loans and leases outstanding in 2018 and \$59,000 or 0.04% (on an annualized basis) of average loans and leases outstanding in 2017. The Company continued to experience an overall improvement in the credit quality of the loan and lease portfolio and a reduction of credit losses. For additional information see the “Allowance for Loan and Lease Losses Activity.”

Noninterest Income

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

Table Four: Components of Noninterest Income

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Service charges on deposit accounts	\$116	\$114	\$233	\$231
Gain on sale/call/impairment of securities	10	86	11	142
Merchant fee income	109	104	219	196
Bank owned life insurance	76	79	151	157
Other	69	56	138	132
Total noninterest income	\$380	\$439	\$752	\$858

Noninterest income decreased \$59,000, or (13.4%), to \$380,000 for the three months ended June 30, 2018 compared to \$439,000 for the three months ended June 30, 2017. The decrease from the second quarter of 2017 to the second quarter of 2018 was primarily related to a decrease in gain on sale of securities, which decreased \$76,000 from a gain of \$86,000 in 2017 to a gain of \$10,000 in 2018.

For the six months ended June 30, 2018, noninterest income decreased \$106,000, or (12.4%), from \$858,000 to \$752,000. The decrease from the first six months of 2017 compared to the same period in 2018 was primarily related to lower gain on sale of securities (down \$131,000 or 92.3%) resulting in income of \$142,000 in the first half of 2017 compared to \$11,000 for the first half of 2018.

Noninterest Expense

Noninterest expense increased \$460,000, or 13.7%, to \$3,828,000 for the three months ended June 30, 2018 compared to \$3,368,000 for the three months ended June 30, 2017. Salary and employee benefits expense increased \$453,000, or 21.9%, from \$2,064,000 during the second quarter of 2017 to \$2,517,000 during the second quarter of 2018. The increase in salaries and benefits expense resulted from filling some vacant positions, hiring additional relationship managers and creating a position for a Chief Lending Officer. Average full-time equivalent employees was 92 during the second quarter of 2017 compared to 97 during the second quarter of 2018. Additional costs in the second quarter of 2018 associated with hiring the new staff include signing bonuses of \$60,000 and placement fees of \$108,000. Occupancy expense was \$262,000 for the second quarters of 2018 and 2017 and furniture and equipment expense decreased \$11,000, or (7.5%), from the second quarter of 2017 to the second quarter of 2018. FDIC assessments increased \$1,000 from the second quarter of 2017 to the second quarter of 2018. OREO related expenses decreased

\$15,000 during the second quarter of 2017 to a credit of \$3,000, from \$12,000 in the second quarter of 2017. The credit balance in 2018 relates to a refund of property taxes paid in prior years. Other expenses increased \$32,000, or 3.9%, to \$863,000 in the second quarter of 2018 compared to \$831,000 in the second quarter of 2017. The increase in other expenses relates to higher advertising and business development expenses in 2018. The fully taxable equivalent efficiency ratio for the second quarter of 2018 was 68.9% compared to 62.3% in the second quarter of 2017.

Noninterest expense for the six-month period ended June 30, 2018 was \$7,178,000 compared to \$6,798,000 for the same period in 2017, an increase of \$380,000, or 5.6%. Salaries and benefits expense increased \$489,000, or 11.5%, from \$4,234,000 for the six months ended June 30, 2017 to \$4,723,000 for the same period in 2018. The increase in salaries and benefits expense resulted from filling some vacant positions, hiring additional relationship managers and creating a position for a Chief Lending Officer. Additional costs in the first six months of 2018 associated with hiring the new staff include signing bonuses of \$60,000 and placement fees of \$164,000. Occupancy expense decreased \$7,000, or (1.3%), and furniture and equipment expense decreased \$24,000, or (8.1%). FDIC assessments increased \$1,000 from \$105,000 in 2017 to \$106,000 in 2018. OREO related expenses decreased \$30,000, or (93.8%), during 2018 to \$2,000, from \$32,000 in 2017. Other expenses decreased \$49,000, or (3.1%), from \$1,598,000 for the six months ended June 30, 2017 to \$1,549,000 for the same period in 2018.

The overhead efficiency ratio (fully taxable equivalent), for the first six months of 2018 was 66.9% as compared to 63.3% in the same period of 2017.

Provision for Income Taxes

Federal and state income taxes for the quarter ended June 30, 2018 decreased \$240,000, or (37.3%), from \$643,000 in the second quarter of 2017 to \$403,000 in the second quarter of 2018 and decreased \$450,000, or (35.7%), from \$1,259,000 in the six months ended June 30, 2017 to \$809,000 for the six months ended June 30, 2018. The combined federal and state effective tax rate for the quarter ended June 30, 2018 was 24.1%, compared to 33.1% for the second quarter of 2017. For the six months ended June 30, 2018, the combined federal and state effective tax rate was 23.6% compared to 33.7% for the six months ended June 30, 2017. The lower tax expense and effective tax rate in 2018 resulted from the passage of “H.R.1” commonly referred to as the “Tax Cuts and Jobs Act” which was signed into law by President Trump on December 22, 2017. The Company’s federal income tax rate was reduced to 21% effective January 1, 2018, which was a reduction from the Company’s 2017 rate of 34%.

Balance Sheet Analysis

The Company’s total assets were \$675,256,000 at June 30, 2018 compared to \$655,622,000 at December 31, 2017, representing an increase of \$19,634,000, or 3.0%. Average assets for the three months ended June 30, 2018 were \$681,932,000, which represents an increase of \$34,551,000, or 5.3%, from the balance of \$647,381,000 during the three-month period ended June 30, 2017. Average assets for the six months ended June 30, 2018 were \$683,155,000, which represents an increase of \$33,097,000, or 5.1%, from the average balance of \$650,058,000 during the six-month period ended June 30, 2017.

Federal Funds

The balance held in correspondent banks classified as Federal funds at June 30, 2018, was \$8,000,000 compared to zero at December 31, 2017. The rate paid to the Company on the Federal funds at June 30, 2018 was 1.92%. The primary reason for the increase in Federal funds in 2018 is directly related to the increase in deposit balances during the same period.

Investment Securities

Table Five below summarizes the values of the Company’s investment securities held on June 30, 2018 and December 31, 2017.

Table Five: Investment Securities Composition

(dollars in thousands)

Available-for-sale (at fair value)	June 30, 2018	December 31, 2017
Debt securities:		
U.S. Government Agencies and Sponsored Entities	\$ 256,459	\$ 232,869
Obligations of states and political subdivisions	15,710	22,715
Corporate bonds	6,506	6,626
U.S Treasury bonds	2,985	—
Corporate stock	—	112
Total available-for-sale investment securities	\$ 281,660	\$ 262,322

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Held-to-maturity (at amortized cost)

Debt securities:

U.S. Government Agencies and Sponsored Entities	\$ 330	\$ 378
Total held-to-maturity investment securities	\$ 330	\$ 378

38

The Company classifies its investment securities as available-for-sale or held-to-maturity. The Company's intent is to hold all securities classified as held-to-maturity until maturity and management believes that it has the ability to do so. Securities available-for-sale may be sold to implement asset/liability management strategies and in response to changes in interest rates, prepayment rates and similar factors.

Net unrealized losses on available-for-sale investment securities totaling \$4,387,000 were recorded, net of \$1,397,000 in tax liabilities, as accumulated other comprehensive loss within shareholders' equity at June 30, 2018 and net unrealized gains on available-for-sale investment securities totaling \$456,000 were recorded, net of \$135,000 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2017.

Management periodically evaluates each investment security in a loss position for other than temporary impairment relying primarily on industry analyst reports, observation of market conditions and interest rate fluctuations. Management has the ability and intent to hold securities with established maturity dates until recovery of fair value, which may be until maturity, and believes it will be able to collect all amounts due according to the contractual terms for all of the underlying investment securities; therefore, management does not consider these investments to be other-than-temporarily impaired.

Loans and Leases

The Company's historical lending activities have been in the following principal areas: (1) commercial; (2) commercial real estate; (3) multi-family real estate; (4) real estate construction (both commercial and residential); (5) residential real estate; (6) lease financing receivable; (7) agriculture; and (8) consumer loans. The Company's continuing focus in our market area, new borrowers developed through the Company's marketing efforts, and credit extensions expanded to existing borrowers resulted in the Company originating \$31.6 million in new loans during the first half of 2018. This production was offset by higher than anticipated pay downs and payoffs, and resulted in an overall net decrease in net loans and leases of \$18,161,000, or (5.9%), from \$308,713,000 at December 31, 2017 to \$290,552,000 at June 30, 2018. Despite the decrease in net loans in 2018, the market in which the Company operates has begun to show demand for credit products as the relatively low interest rate environment and continued economic expansion have increased refinancing as well as new loan activity. Table Six below summarizes the composition of the loan portfolio in dollars and as a percentage of total loans as of June 30, 2018 and December 31, 2017.

Table Six: Loan and Lease Portfolio Composition

(dollars in thousands)	June 30, 2018		December 31, 2017		Change in dollars	Percentage change
	\$	%	\$	%		
Commercial Real estate	\$25,026	9 %	\$ 25,377	8 %	\$(351)	(1.4 %)
Commercial	177,544	60 %	185,452	59 %	(7,908)	(4.3 %)
Multi-family	66,068	22 %	78,025	25 %	(11,957)	(15.3 %)
Construction	6,408	2 %	5,863	2 %	545	9.3 %
Residential	16,824	6 %	15,813	5 %	1,011	6.4 %
Lease financing receivable	117	— %	205	— %	(88)	(42.9 %)

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Agriculture	2,603	1 %	1,713	1 %	890	52.0 %
Consumer	749	— %	945	— %	(196)	(20.7 %)
Total loans and leases	295,339	100 %	313,393	100 %	(18,054)	(5.8 %)
Deferred loan and lease fees, net	(295)		(202)		(93)	
Allowance for loan and lease losses	(4,492)		(4,478)		(14)	
Total net loans and leases	\$290,552		\$ 308,713		\$ (18,161)	(5.9 %)

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

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

Risk Elements

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

Ultimately, underlying trends in economic and business cycles influence credit quality. American River Bank's business is concentrated in the Sacramento Metropolitan Statistical Area, which is a diversified economy, but with a large State of California government presence and employment base; in Sonoma County, which is focused on businesses within the two communities in which the Bank has offices (Santa Rosa and Healdsburg); and in Amador County, in which the Bank is primarily focused on businesses within the three communities in which it has offices (Jackson, Pioneer, and Ione). The economy of Sonoma County is diversified with professional services, manufacturing, agriculture and real estate investment and construction, while the economy of Amador County is reliant upon government, services, retail trade, manufacturing industries and Indian gaming. The Company had serviced markets in Santa Clara, Contra Costa, and Alameda Counties through a loan production office. In the fourth quarter of 2016, the Company discontinued operating the loan production office, however, the Company continues to have loans that were originated in these markets. The economies of Santa Clara, Contra Costa and Alameda Counties are diversified with professional services, manufacturing, technology related companies, real estate investment and construction.

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

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

In management's judgment, a concentration exists in real estate loans, which represented approximately 90% of the Company's loan and lease portfolio at June 30, 2018 and 91% as of December 31, 2017. Management believes that the residential land portion of the Company's loan portfolio carries a reasonable level of credit risk. As of June 30, 2018,

outstanding unimproved residential land commitments were \$2,221,000 (or just 0.8% of the total real estate loans). Of the \$2,221,000, \$2,170,000, or 98%, was represented by one amortizing loan, which was considered well-secured, with a favorable loan-to-value ratio. Management currently believes that it maintains its allowance for loan and lease losses at levels adequate to reflect the loss risk inherent in its total loan portfolio.

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

Northern California Wildfires

Beginning on October 8, 2017, much of the North Bay region of Northern California was struck by massive wildfires which destroyed numerous properties and adversely affected the region's economy. Our two offices in Healdsburg and Santa Rosa were not damaged. Some of the Company's clients did lose their homes, but we do not have loans on those properties. We currently believe that losses, if any, to commercial or business properties that secure our loans is not material. At June 30, 2018, the Company had approximately 8% of total loans in the Sonoma County market, the majority of which are secured by commercial property. Management continues to closely monitor the situation and continues to respond to needs of clients and employees. While it is not yet possible to assess the full scope of this disaster or its long-term impact on our clients and the economy of the region, management does not believe that there will be any material impact on the Company's financial position. As of June 30, 2018, none of the loans in the Sonoma County market were greater than 30 days past due.

Nonperforming, Past Due and Restructured Loans and Leases

At June 30, 2018, nonperforming loans and leases (those loans and leases on nonaccrual status and those loans and leases still accruing and past due 90 days or more) were \$1,944,000 or 0.66% of total loans and leases. The \$1,944,000 in nonperforming loans and leases consisted of one commercial loan totaling \$1,562,000, one commercial real estate loan totaling \$283,000, one commercial loan relationship with two loans totaling \$31,000, and one \$68,000 consumer equity loan. The \$1,562,000 commercial loan is a shared national credit to a large retailer purchased by the Company in 2013. The initial loan balance was \$3,000,000 and had paid as agreed, down to \$2,692,000, until September 2017, when the retailer filed for bankruptcy reorganization. At that time the loan was placed on nonaccrual and the loan balance was subsequently reduced by \$1,095,000 through a \$1,073,000 loss charged to the loan and lease loss allowance and \$57,000 applied to principal from payments made by the borrower. This bankruptcy filing occurred late in the third quarter of 2017 and the Company has been using the latest information available to perform an impairment analysis. As more information becomes available, the Company will update the impairment analysis, which could lead to further charges to the loan loss allowance. As of June 30, 2018, the loan also has a \$200,000 specific reserve to account for uncertainty, reducing the net exposure to \$1,362,000. Nonperforming loans and leases were \$1,892,000 or 0.60% of total loans and leases at December 31, 2017. There were no specific reserves held on the nonperforming loans at December 31, 2017.

There were no loan or lease concentrations in excess of 10% of total loans and leases not otherwise disclosed as a category of loans and leases as of June 30, 2018. Management is not aware of any potential problem loans, which were accruing and current at June 30, 2018, where serious doubt exists as to the ability of the borrower to comply with the present repayment terms and that would result in a significant loss to the Company.

Table Seven below sets forth nonaccrual loans and loans past due 90 days or more as of June 30, 2018 and December 31, 2017.

Table Seven: Nonperforming Loans and Leases

(dollars in thousands)	June 30, 2018	December 31, 2017
Past due 90 days or more and still accruing:		
Commercial	\$ —	\$ —
Real estate	—	—
Lease financing receivable	—	—
Agriculture	—	—
Consumer	—	—
Nonaccrual:		
Commercial	1,593	1,597
Real estate	283	289
Lease financing receivable	—	—
Agriculture	—	—
Consumer	68	6
Total nonperforming loans	\$ 1,944	\$ 1,892

Impaired Loans and Leases

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

At June 30, 2018, the recorded investment in loans and leases that were considered to be impaired totaled \$11,981,000, all of which are considered performing loans and leases. Of the total impaired loans of \$11,981,000, loans totaling \$6,385,000 were deemed to require no specific reserve and loans totaling \$5,596,000 were deemed to require a related valuation allowance of \$446,000. Of the \$6,385,000 impaired loans that did not carry a specific reserve there were \$500,000 in loans or leases that had previous partial charge-offs and \$5,885,000 in loans or leases that were analyzed and determined not to require a specific reserve or charge-off because the collateral value or discounted cash flow value exceeded the loan or lease balance. Of the \$11,981,000 in loans considered to be impaired, \$1,913,000 were nonperforming loans and leases. The recorded investment in loans and leases that were considered to be impaired totaled \$13,757,000 at December 31, 2017. Of the total impaired loans of \$13,757,000, loans totaling \$7,601,000 were deemed to require no specific reserve and loans totaling \$6,156,000 were deemed to require a related

valuation allowance of \$355,000.

The Company has been operating in a market that has recently experienced sporadic improvement in real estate values of commercial, residential, land, and construction properties. As such, the Company is focused on monitoring collateral values for those loans considered collateral dependent. For collateral dependent loans in excess of \$250,000, the Company performs an internal evaluation or obtains an updated appraisal, as necessary, which is generally once every twelve months. In the second quarter of 2018, the Company had net recoveries of \$4,000 with no provision. In the second quarter of 2017, the Company had net recoveries of \$48,000 with no provision.

During the quarters ended June 30, 2018 and June 30, 2017, there were no loans that were modified as troubled debt restructurings. There were no payment defaults on troubled debt restructurings within 12 months following the modification for the three-month and six-month periods ended June 30, 2018, with the exception of one commercial loan with a June 30, 2018 balance of \$1,562,000. There were no payment defaults on troubled debt restructurings within 12 months following the modification for the three-month and six-month periods ended June 30, 2017. At June 30, 2018 and December 31, 2017 there were no unfunded commitments on those loans considered troubled debt restructures.

Allowance for Loan and Lease Losses Activity

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

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

The ALLL totaled \$4,492,000 or 1.52% of total loans and leases at June 30, 2018 compared to \$4,478,000 or 1.43% of total loans and leases at December 31, 2017. The Company establishes general and specific reserves in accordance with accounting principles generally accepted in the United States of America. The ALLL is composed of categories of the loan and lease portfolio based on loan type and loan rating; however, the entire allowance is available to cover actual loan and lease losses. While management uses available information to recognize possible losses on loans and leases, future additions to the allowance may be necessary, based on changes in economic conditions and other matters. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company’s ALLL. Such agencies may require the Company to provide additions to the allowance based on their judgment of information available to them at the time of their examination.

The ALLL as a percentage of impaired loans and leases was 37.5% at June 30, 2018 and 32.6% at December 31, 2017. Of the total nonperforming and impaired loans and leases outstanding as of June 30, 2018, there were \$2,417,000 in loans or leases that had been reduced by partial charge-offs of \$1,476,000. As these loan or lease balances are charged off, the remaining balances, following analysis, normally do not initially require specific reserves and are not eligible for general reserves. The impact of this on credit ratios is such that the Company’s ALLL as a percentage may be lower, because the partial charge-offs have reduced the potential future losses related to those credits.

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

It is the policy of management to maintain the allowance for loan and lease losses at a level believed to be adequate for known and inherent risks in the portfolio. Our methodology incorporates a variety of risk considerations, both quantitative and qualitative, in establishing an allowance for loan and lease losses that management believes is appropriate at each reporting date. Based on information currently available to analyze inherent credit risk, including

economic factors, overall credit quality, historical delinquencies and a history of actual charge-offs, management believes that the provision for loan and lease losses and the allowance for loan and lease losses are prudent and adequate. Adjustments may be made based on differences from estimated loan and lease growth, the types of loans constituting this growth, changes in risk ratings within the portfolio, and general economic conditions. However, no prediction of the ultimate level of loans and leases charged off in future periods can be made with any certainty.

Table Eight below summarizes, for the periods indicated, the activity in the ALLL.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Average loans and leases outstanding	\$304,732	\$316,423	\$305,992	\$318,258
Allowance for loan and lease losses at beginning of period	\$4,488	\$4,833	\$4,478	\$4,822
Loans and leases charged off:				
Commercial	—	—	—	—
Real estate	—	—	—	—
Lease financing receivable	—	—	—	—
Agriculture	—	—	—	—
Consumer	—	—	—	—
Total	—	—	—	—
Recoveries of loans and leases previously charged off:				
Commercial	2	2	9	3
Real estate	2	44	4	53
Lease financing receivable	—	—	1	—
Agriculture	—	—	—	—
Consumer	—	2	—	3
Total	4	48	14	59
Net loans and leases charged off	4	48	14	59
Additions to allowance charged to operating expenses	—	—	—	—
Allowance for loan and lease losses at end of period	\$4,492	\$4,881	\$4,492	\$4,881
Ratio of net charge-offs to average loans and leases outstanding (annualized)	-0.01	% -0.06	% -0.01	% -0.04
Provision of allowance for loan and lease losses to average loans and leases outstanding (annualized)	0.00	% 0.00	% 0.00	% 0.00
Allowance for loan and lease losses to loans and leases net of deferred fees at end of period	1.52	% 1.52	% 1.52	% 1.52

Other Real Estate Owned

At June 30, 2018 and December 31, 2017, the Company had one other real estate owned (“OREO”) property totaling \$961,000. During 2018, the Company did not acquire or sell any OREO properties nor were there any impairment charges to this property. There was no valuation allowance at June 30, 2018 nor at year end 2017. The Company believes that the OREO property owned at June 30, 2018 was carried approximately at fair value.

Deposits

At June 30, 2018, total deposits were \$581,316,000 representing a \$25,236,000, or 4.5%, increase from the December 31, 2017 balance of \$556,080,000. The Company’s deposit growth plan for 2018 is to concentrate its efforts on increasing noninterest-bearing demand, interest-bearing money market and NOW accounts, and savings accounts while allowing higher cost time deposits to mature and close or renew at lower rates. During the first six months of

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2018, the Company experienced increases in noninterest-bearing (\$5,874,000 or 2.7%), interest-bearing checking (\$2,020,000 or 3.1%), money market accounts (\$15,769,000 or 12.1%), and savings (\$4,054,000 or 6.1%) and a decrease in time (\$2,481,000 or 3.1%) deposits.

Other Borrowed Funds

Other borrowings outstanding as of June 30, 2018 and December 31, 2017, consist of advances (both long-term and short-term) from the Federal Home Loan Bank of San Francisco (“FHLB”). Table Nine below summarizes these borrowings.

Table Nine: Other Borrowed Funds

(dollars in thousands)

	June 30, 2018		December 31, 2017	
	Amount	Rate	Amount	Rate
Short-term borrowings:				
FHLB advances	\$6,500	1.29%	\$3,500	1.39%
Long-term borrowings:				
FHLB advances	\$9,000	1.49%	\$12,000	1.41%

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

	Short-term	Long-term
Amount	\$6,500	\$13,500
Maturity	2018 to 2019	2019 to 2021
Weighted average rates	1.29%	1.49%

Capital Resources

The Company and American River Bank are subject to certain regulatory capital requirements administered by the Federal Reserve Board and the Federal Deposit Insurance Corporation (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 current capital adequacy guidelines and the regulatory framework for prompt corrective action, banks must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company’s and American River Bank’s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

At June 30, 2018, shareholders’ equity was \$71,893,000, representing a decrease of \$5,028,000, or (6.5%), from \$76,921,000 at December 31, 2017. The decrease results from repurchases of common stock (\$4,654,000), the payment of cash dividends (\$601,000), and the reductions from other comprehensive income (\$2,669,000), exceeding the additions from net income for the period (\$2,622,000) and the stock based compensation (\$274,000). The Company’s ratio of total risk-based capital to risk adjusted assets was 18.8% at June 30, 2018 and 19.3% at December 31, 2017. Tier 1 risk-based capital to risk-adjusted assets was 17.6% at June 30, 2018 and 18.1% at December 31, 2017. The leverage ratio was 8.8% at June 30, 2018 and 9.5% at December 31, 2017.

Capital ratios are reviewed on a regular basis to ensure that capital exceeds the prescribed regulatory requirements and is adequate to meet future needs. Management believes that both the Company and American River Bank met all of their capital adequacy requirements as of June 30, 2018 and December 31, 2017.

Table Ten below lists the Company's and American River Bank's capital ratios at June 30, 2018 and December 31, 2017 as well as the minimum regulatory requirements.

45

Table Ten: Capital Ratios

Capital to Risk-Adjusted Assets	June 30,		December 31,		Minimum Regulatory Capital Requirements			
	2018		2017		2018		2017	
American River Bankshares								
Leverage Ratio	8.8	%	9.5	%	5.9	%	5.3	%
Tier 1 Risk-Based Capital	17.6	%	18.1	%	7.9	%	7.3	%
Total Risk-Based Capital	18.8	%	19.3	%	9.9	%	9.3	%
American River Bank								
Leverage Ratio	8.8	%	9.3	%	5.9	%	5.3	%
Common Equity Tier 1 Risk-Based Capital	17.5	%	17.7	%	6.4	%	5.8	%
Tier 1 Risk-Based Capital	17.5	%	17.7	%	7.9	%	7.3	%
Total Risk-Based Capital	18.7	%	19.0	%	9.9	%	9.3	%

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

In addition, a “capital conservation buffer,” is established which when fully phased-in will require maintenance of a minimum of 2.5% of common equity Tier 1 capital to total risk weighted assets in excess of the regulatory minimum capital ratio requirements described above. The 2.5% buffer will increase the minimum capital ratios to (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. The new buffer requirement will be phased-in between January 1, 2016 and January 1, 2019. The buffer requirement for 2018 is 1.875% and will increase to 2.50% on January 1, 2019. If the capital ratio levels of a banking organization fall below the capital conservation buffer amount, the organization will be subject to limitations on (i) the payment of dividends; (ii) discretionary bonus payments; (iii) discretionary payments under Tier 1 instruments; and (iv) engaging in share repurchases.

On January 24, 2018, the Company approved and authorized a 5% stock repurchase program for 2018 (the “2018 Program”). See Part II, Item 2, for additional disclosure regarding the 2018 Program. In addition, on February 14, 2018 and May 16, 2018, the Company paid \$0.05 per common share cash dividends to shareholders. These 2018 quarterly dividends follows four quarterly cash dividends, totaling \$0.20 per share in the aggregate, paid in 2017.

Inflation

The impact of inflation on a financial institution differs significantly from that exerted on manufacturing or other commercial concerns primarily because its assets and liabilities are largely monetary. In general, inflation primarily affects the Company and its subsidiaries through its effect on market rates of interest, which affects the Company’s

ability to attract loan customers. Inflation affects the growth of total assets by increasing the level of loan demand and potentially adversely affects capital adequacy because loan growth in inflationary periods can increase at rates higher than the rate that capital grows through retention of earnings which may be generated in the future. In addition to its effects on interest rates, inflation increases overall operating expenses. Inflation has not had a significant effect upon the results of operations of the Company and its subsidiaries during the periods ended June 30, 2018 and 2017.

Liquidity

Liquidity management refers to the Company's ability to provide funds on an ongoing basis to meet fluctuations in deposit levels as well as the credit needs and requirements of its clients. Both assets and liabilities contribute to the Company's liquidity position. Federal funds lines, short-term investments and securities, and loan and lease repayments contribute to liquidity, along with deposit increases, while loan and lease funding and deposit withdrawals decrease liquidity. The Company assesses the likelihood of projected funding requirements by reviewing historical funding patterns, current and forecasted economic conditions and individual client funding needs. Commitments to fund loans and outstanding standby letters of credit at June 30, 2018 were approximately \$21,966,000 and \$121,000, respectively. Such loan commitments relate primarily to revolving lines of credit and other commercial loans and to real estate construction loans. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company's sources of liquidity consist of cash and due from correspondent banks, overnight funds sold to correspondent banks, unpledged marketable investments and loans held for sale and/or pledged for secured borrowings. At June 30, 2018, consolidated liquid assets totaled \$247.7 million or 37.0% of total assets compared to \$226.3 million or 34.5% of total assets on December 31, 2017. In addition to liquid assets, the Company maintains two short-term unsecured lines of credit in the amount of \$17,000,000 with two of its correspondent banks. At June 30, 2018, the Company had \$17,000,000 available under these credit lines. Additionally, the Bank is a member of the FHLB. At June 30, 2018, the Bank could have arranged for up to \$123,777,000 in secured borrowings from the FHLB. These borrowings are secured by pledged mortgage loans and investment securities. At June 30, 2018, the Bank had advances, borrowings and commitments (including letters of credit) outstanding of \$15,500,000, leaving \$108,277,000 available under these FHLB secured borrowing arrangements. The Bank also has a secured borrowing arrangement with the Federal Reserve Bank of San Francisco. The borrowing can be secured by pledging selected loans and investment securities. At June 30, 2018, the Bank's borrowing capacity at the Federal Reserve Bank was \$7,920,000. The Company serves primarily a business and professional customer base and, as such, its deposit base is susceptible to economic fluctuations. Accordingly, management strives to maintain a balanced position of liquid assets and borrowing capacity to offset the potential runoff of these volatile and/or cyclical deposits.

Liquidity is also affected by portfolio maturities and the effect of interest rate fluctuations on the marketability of both assets and liabilities. The Company can sell any of its unpledged securities held in the available-for-sale category to meet liquidity needs. Furthermore, the Bank can pledge additional unencumbered securities to borrow from the Federal Reserve Bank of San Francisco and the FHLB.

Off-Balance Sheet Items

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet.

The Company's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Company applies the same credit policies to commitments and letters of credit as it does for loans included on the consolidated balance sheet. As of June 30, 2018 and December 31, 2017, commitments to extend credit and standby letters of credit were the only financial instruments with off-balance sheet risk. The Company has not entered into any contracts for financial derivative instruments such as futures, swaps, options or similar instruments. Loan commitments and standby letters of credit were \$22,087,000 and \$11,044,000 at June 30, 2018 and December 31, 2017, respectively. As a percentage of net loans and leases these off-balance sheet items represent 7.6% and 3.6%, respectively.

The Company has certain ongoing commitments under operating leases. These commitments do not significantly impact operating results.

Website Access

The Company maintains a website where certain information about the Company is posted. Through the website, its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments thereto, as well as Section 16 Reports and amendments thereto, are available as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. These reports are free of charge and can be accessed through the address www.americanriverbank.com by accessing the *Investor Relations* link, then the *Company News* link, then the *SEC Filings* link located at that address. Once you have selected the *SEC Filings* link you will have the option to access the Section 16 Reports or the reports filed on Forms 10-K, 10-Q and 8-K by the Company by selecting the appropriate link.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

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

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

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

Table Eleven below summarizes the effect on net interest income (NII) of a ± 100 and ± 200 basis point change in interest rates as measured against a constant rate (no change) scenario.

Table Eleven: Interest Rate Risk Simulation of Net Interest as of June 30, 2018

	\$ Change in NII	\$ Change in NII
(dollars in thousands)	from Current	from Current
	12 Month Horizon	24 Month Horizon
Variation from a constant rate scenario		
+100bp	\$ 338	\$ 932

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+200bp	\$ 647		\$ 1,764	
-100bp	\$ (705)	\$ (1,830)
-200bp	\$ (1,431)	\$ (3,739)

Simulation of earnings is the primary tool used to measure the sensitivity of earnings to interest rate changes. Using computer-modeling techniques, with specialized software built for this specific purpose for financial institutions, the Company is able to estimate the potential impact of changing interest rates on earnings, net interest margin and market value of equity. A balance sheet is prepared using detailed inputs of actual loans, securities and interest-bearing liabilities (i.e. deposits/borrowings). The balance sheet is processed using multiple interest rate scenarios. The scenarios include a rising rate forecast, a flat rate forecast and a falling rate forecast which take place within a one-year time frame. The net interest income is measured over one-year and two-year periods assuming a gradual change in rates over the twelve-month horizon. The simulation modeling attempts to estimate changes in the Company's net interest income utilizing a detailed current balance sheet. After a review of the model results as of June 30, 2018, the Company does not consider the fluctuations from the base case, to have a material impact on the Company's projected results and are within the tolerance levels outlined in the Company's interest rate risk policies. The simulations of earnings do not incorporate any management actions, which might moderate the negative consequences of interest rate deviations. Therefore, they do not reflect likely actual results, but serve as reasonable estimates of interest rate risk.

Item 4. Controls and Procedures.

The Company, under the supervision and with the participation of its management, including the Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's "disclosure controls and procedures" (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of June 30, 2018. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report.

During the quarter ended June 30, 2018, there have been no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, these controls.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

From time to time, the Company and/or its subsidiaries is a party to claims and legal proceedings arising in the ordinary course of business. The Company's management is not aware of any significant pending legal proceedings to which either it or its subsidiaries may be a party or has recently been a party, which will have a significant adverse effect on the financial condition or results of operations of the Company or its subsidiaries, taken as a whole.

Item 1A. Risk Factors.

There have been no significant changes in the risk factors previously disclosed in the Company's Form 10-K for the period ended December 31, 2017, filed with the Securities and Exchange Commission on February 27, 2018.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

On January 25, 2017, the Company approved and authorized a stock repurchase program for 2017 (the "2017 Program"). The 2017 Program authorized the repurchase during 2017 of up to 5% of the outstanding shares of the Company's common stock, or approximately 333,086 shares based on the 6,661,726 shares outstanding as of December 31, 2016. Repurchases under the 2017 Program were made from time to time by the Company in the open market. All such transactions were structured to comply with SEC Rule 10b-18 and all shares repurchased under the 2017 Program were retired.

On January 24, 2018, the Company approved and authorized a stock repurchase program for 2018 (the "2018 Program"). The 2018 Program authorized the repurchase during 2018 of up to 5% of the outstanding shares of the Company's common stock, or approximately 306,618 shares based on the 6,132,362 shares outstanding as of

December 31, 2017. Any repurchases under the 2018 Program will be made from time to time by the Company in the open market as conditions allow. All such transactions will be structured to comply with SEC Rule 10b-18 and all shares repurchased under the 2018 Program will be retired. The number, price and timing of the repurchases will be at the Company's sole discretion and the 2018 Program may be re-evaluated depending on market conditions, capital and liquidity needs or other factors. Based on such re-evaluation, the Board of Directors may suspend, terminate, modify or cancel the 2018 Program at any time without notice. The following table lists shares repurchased during the quarter ended June 30, 2018 and the maximum amount available to repurchase under the repurchase plan.

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Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid Per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) That May Yet Be Purchased Under the Plans or Programs
Month #1				
April 1 through	-	-	-	42,440
April 30, 2018				
Month #2				
May 1 through	-	-	-	42,440
May 31, 2018				
Month #3				
June 1 through	34,600	\$16.00	34,600	7,840
June 30, 2018				
Total	34,600	\$16.00	34,600	N/A

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit
Number Document Description

Employment Agreement dated May 31, 2018, between the Registrant and Dan C. McGregor, incorporated *(10.01) by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on June 1, 2018.**

(31.1) Certifications of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.**

(31.2) Certifications of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.**

(32.1) Certification of American River Bankshares by its Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.***

101.INS XBRL Instance Document**

101.SCH XBRL Taxonomy Extension Schema**

101.CALXBRL Taxonomy Extension Calculation**

101.DEF XBRL Taxonomy Extension Definition**

101.LAB XBRL Taxonomy Extension Label**

101.PRE XBRL Taxonomy Extension Presentation**

*Denotes management contracts, compensatory plans or arrangements.

**Filed herewith

***Furnished herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AMERICAN RIVER BANKSHARES

August 9, 2018 By: /s/ DAVID E. RITCHIE, JR.

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

AMERICAN RIVER BANKSHARES

August 9, 2018 By: /s/ MITCHELL A. DERENZO

Mitchell A. Derenzo
Executive Vice President and
Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT INDEX

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