COMMUNITY WEST BANCSHARES /
Form 10-Q
November 06, 2015

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 September 30, 2015 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: 000-23575

COMMUNITY WEST BANCSHARES
(Exact name of registrant as specified in its charter)

California	77-0446957
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

445 Pine Avenue, Goleta, California	93117
(Address of principal executive offices)	(Zip Code)

(805) 692-5821
(Registrant's telephone number, including area code)

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, or a smaller reporting company. See definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

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

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

Common stock of the registrant issued and outstanding of 8,201,158 as of October 31, 2015.

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The financial statements included in this Form 10-Q should be read in conjunction with Community West Bancshares' Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

COMMUNITY WEST BANCSHARES
CONSOLIDATED BALANCE SHEETS

	September 30, 2015 (unaudited)	December 31, 2014
	(in thousands, except share amounts)	
Assets:		
Cash and due from banks	$1,854	$1,609
Federal funds sold	22	22
Interest-earning demand in other financial institutions	21,817	17,328
Cash and cash equivalents	23,693	18,959
Money market investments	99	99
Investment securities - available-for-sale, at fair value; amortized cost of $24,007 at September 30, 2015 and $22,141 at December 31, 2014	23,956	22,194
Investment securities - held-to-maturity, at amortized cost; fair value of $7,672 at September 30, 2015 and $8,894 at December 31, 2014	7,245	8,447
Federal Home Loan Bank stock, at cost	1,886	1,716
Federal Reserve Bank stock, at cost	1,373	1,373
Loans:		
Held for sale, at lower of cost or fair value	65,491	66,759
Held for investment, net of allowance for loan losses of $7,012 at September 30, 2015 and $7,877 at December 31, 2014	460,495	420,497
Total loans	525,986	487,256
Other assets acquired through foreclosure, net	206	137
Premises and equipment, net	2,956	3,053
Other assets	13,637	14,084
Total assets	$601,037	$557,318
Liabilities:		
Deposits:		
Non-interest-bearing demand	$73,073	$57,364
Interest-bearing demand	250,738	275,631
Savings	13,943	15,265
Certificates of deposit ($250,000 or more)	56,745	13,601
Other certificates of deposit	132,287	115,223
Total deposits	526,786	477,084
Other borrowings	5,000	10,000
Other liabilities	3,339	3,227
Total liabilities	535,125	490,311
Stockholders’ equity:		
Preferred stock — no par value, 10,000,000 shares authorized; 5,574 shares issued and outstanding at September 30, 2015 and 7,014 at December 31, 2014	5,574	7,014
Common stock — no par value, 20,000,000 shares authorized; 8,201,158 shares issued and outstanding at September 30, 2015 and 8,203,033 at December 31, 2014	42,272	41,957

Retained earnings	18,096	18,005
Accumulated other comprehensive income (loss)	(30)	31
Total stockholders’ equity	65,912	67,007
Total liabilities and stockholders’ equity	$601,037	$557,318

See the accompanying notes.

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COMMUNITY WEST BANCSHARES
CONSOLIDATED INCOME STATEMENTS (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(in thousands, except per share amounts)			
Interest income:				
Loans, including fees	$7,131	$6,695	$21,253	$20,367
Investment securities and other	244	208	834	619
Total interest income	7,375	6,903	22,087	20,986
Interest expense:				
Deposits	587	709	1,761	2,039
Other borrowings	6	126	82	524
Total interest expense	593	835	1,843	2,563
Net interest income	6,782	6,068	20,244	18,423
Provision (credit) for loan losses	(445)	(1,178)	(1,997)	(3,560)
Net interest income after provision for loan losses	7,227	7,246	22,241	21,983
Non-interest income:				
Other loan fees	244	279	789	720
Document processing fees	141	103	364	297
Service charges	92	72	252	215
Other	77	98	366	494
Total non-interest income	554	552	1,771	1,726
Non-interest expenses:				
Salaries and employee benefits	3,412	2,888	9,729	9,308
Occupancy, net	507	479	1,439	1,377
Professional services	212	436	736	1,167
Data processing	135	144	388	425
Advertising and marketing	116	129	348	429
Stock based compensation	73	29	333	270
Depreciation	103	82	290	238
Loan servicing and collection	10	187	281	586
FDIC assessment	99	83	252	253
Loan litigation settlement, net	(50)	—	7,103	—
Other	421	422	1,291	1,382
Total non-interest expenses	5,038	4,879	22,190	15,435
Income before provision for income taxes	2,743	2,919	1,822	8,274
Provision for income taxes	1,152	1,207	803	3,414
Net income	1,591	1,712	1,019	4,860
Dividends on preferred stock	125	176	401	778
Discount on partial redemption of preferred stock	—	—	(129)	(144)
Net income available to common stockholders	$1,466	$1,536	$747	$4,226
Earnings per share:				
Basic	$0.18	$0.19	$0.09	$0.52
Diluted	$0.17	$0.18	$0.09	$0.51
Weighted average number of common shares outstanding:				
Basic	8,203	8,200	8,204	8,120
Diluted	8,508	8,494	8,503	8,512

Dividends declared per common share	$0.03	$0.02	$0.08	$0.02

See the accompanying notes.

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COMMUNITY WEST BANCSHARES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(in thousands)			
Net income	$1,591	$1,712	$1,019	$4,860
Other comprehensive income (loss), net:				
Unrealized income (loss) on securities available-for-sale (AFS), net (tax effect of ($64),($23), $42, ($130) for each respective period presented)	92	34	(61)	188
Net other comprehensive income (loss)	92	34	(61)	188
Comprehensive income	$1,683	$1,746	$958	$5,048

See the accompanying notes.

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COMMUNITY WEST BANCSHARES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (unaudited)

	Preferred Stock		Common Stock		Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
	Shares	Amount	Shares	Amount			
	(in thousands)						
Balance, December 31, 2014:	7	$7,014	8,203	$41,957	$ 31	$18,005	$ 67,007
Net income	—	—	—	—	—	1,019	1,019
Exercise of stock options	—	—	1	3	—	—	3
Stock option expense	—	—	—	333	—	—	333
Preferred stock redemption and discount	(1)	(1,440)	—	—	—	129	(1,311)
Common stock repurchase	—	—	(3)	(21)	—	—	(21)
Dividends on preferred stock	—	—	—	—	—	(401)	(401)
Dividends on common stock	—	—	—	—	—	(656)	(656)
Other comprehensive loss, net	—	—	—	—	(61)	—	(61)
Balance, September 30, 2015	6	$5,574	8,201	$42,272	$ (30)	$18,096	$ 65,912

See the accompanying notes.

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COMMUNITY WEST BANCSHARES

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Nine Months Ended September 30,	
	2015	2014
	(in thousands)	
Cash flows from operating activities:		
Net income	$1,019	$4,860
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Provision for loan losses	(1,997)	(3,560)
Depreciation	290	238
Stock-based compensation	333	270
Deferred income taxes	42	(581)
Net accretion of discounts and premiums for investment securities	(71)	(31)
(Gains)/Losses on:		
Sale of repossessed assets, net	(33)	(168)
Sale of loans, net	(83)	(150)
Sale of assets, net	32	—
Loans originated for sale and principal collections, net	1,351	(2,827)
Changes in:		
Other assets	537	5,369
Other liabilities	(6)	1,238
Servicing rights, net	44	168
Net cash provided by operating activities	1,459	4,826
Cash flows from investing activities:		
Principal pay downs and maturities of available-for-sale securities	5,635	1,438
Purchase of available-for-sale securities	(7,416)	(5,132)
Proceeds from principal pay downs and maturities of securities held-to-maturity	1,189	1,099
Loan originations and principal collections, net	(38,545)	(22,427)
(Purchase) liquidation of restricted stock, net	(170)	154
Purchase of premises and equipment, net	(225)	(233)
Proceeds from sale of other real estate owned and repossessed assets, net	508	3,552
Net cash used in investing activities	(39,025)	(21,549)
Cash flows from financing activities:		
Net increase in deposits	49,702	48,615
Net decrease in borrowings	(5,000)	(12,034)
Exercise of stock options	3	52
Cash dividends paid on common stock	(656)	(164)
Common stock repurchase	(21)	—
Redemption of preferred stock	(1,311)	(7,660)
Cash dividends paid on preferred stock	(417)	(2,222)
Net cash provided by financing activities	42,300	26,587
Net increase in cash and cash equivalents	4,734	9,864
Cash and cash equivalents at beginning of year	18,959	19,478
Cash and cash equivalents at end of period	$23,693	$29,342
Supplemental disclosure:		
Cash paid during the period for:		
Interest	$1,830	$2,513
Income taxes	650	2,301

Non-cash investing and financing activity:		
Transfers to other assets acquired through foreclosure, net	544	928
Conversion of debentures	—	1,408

See the accompanying notes.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Community West Bancshares ("CWBC"), incorporated under the laws of the state of California, is a bank holding company providing full service banking through its wholly-owned subsidiary Community West Bank, N.A. ("CWB" or the "Bank"). These entities are collectively referred to herein as the "Company."

Basis of Presentation

The accounting and reporting policies of the Company are in accordance with accounting principles generally accepted in the United States ("GAAP") and conform to practices within the financial services industry. The accounts of the Company and its consolidated subsidiary are included in these Consolidated Financial Statements. All significant intercompany balances and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan losses, the fair value of other real estate owned and the fair value of securities available for sale. Although Management believes these estimates to be reasonably accurate, actual amounts may differ. In the opinion of Management, all adjustments considered necessary have been reflected in the financial statements during their preparation.

Interim Financial Information

The accompanying unaudited consolidated financial statements as of and for the three and nine months ended September 30, 2015 and 2014 have been prepared in a condensed format, and therefore do not include all of the information and footnotes required by GAAP for complete financial statements. These statements have been prepared on a basis that is substantially consistent with the accounting principles applied to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2014.

The information furnished in these interim statements reflects all adjustments which are, in the opinion of management, necessary for a fair statement of the results for each respective period presented. Such adjustments are of a normal recurring nature. The results of operations in the interim statements are not necessarily indicative of the results that may be expected for any other quarter or for the full year. The interim financial information should be read in conjunction with the Company's audited consolidated financial statements.

Reclassifications

Certain amounts in the consolidated financial statements as of December 31, 2014 and for the three and nine months ended September 30, 2014 have been reclassified to conform to the current presentation. The reclassifications have no effect on net income, comprehensive income or stockholders' equity as previously reported.

Loans Held For Sale

Loans which are originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value determined on an aggregate basis. Valuation adjustments, if any, are recognized through a valuation allowance by charges to lower of cost or fair value provision. Loans held for sale are mostly comprised of SBA and commercial agriculture. On August 14, 2015 the Company announced its exit from originating single family residential loans for sale. The Company did not incur any lower of cost or fair value provision in the three and nine months ended September 30, 2015 and 2014.

Loans Held for Investment and Interest and Fees from Loans

Loans are recognized at the principal amount outstanding, net of unearned income, loan participations and amounts charged off. Unearned income includes deferred loan origination fees reduced by loan origination costs. Unearned income on loans is amortized to interest income over the life of the related loan using the level yield method.

Interest income on loans is accrued daily using the effective interest method and recognized over the terms of the loans. Loan fees collected for the origination of loans less direct loan origination costs (net deferred loan fees) are amortized over the contractual life of the loan through interest income. If the loan has scheduled payments, the amortization of the net deferred loan fee is calculated using the interest method over the contractual life of the loan. If the loan does not have scheduled payments, such as a line of credit, the net deferred loan fee is recognized as interest income on a straight-line basis over the contractual life of the loan commitment. Commitment fees based on a percentage of a customer’s unused line of credit and fees related to standby letters of credit are recognized over the commitment period.

When loans are repaid, any remaining unamortized balances of unearned fees, deferred fees and costs and premiums and discounts paid on purchased loans are accounted for through interest income.

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Nonaccrual loans: For all loan types, when a borrower discontinues making payments as contractually required by the note, the Company must determine whether it is appropriate to continue to accrue interest. Generally, the Company places loans in a nonaccrual status and ceases recognizing interest income when the loan has become delinquent by more than 90 days or when Management determines that the full repayment of principal and collection of interest is unlikely. The Company may decide to continue to accrue interest on certain loans more than 90 days delinquent if they are well secured by collateral and in the process of collection. Other personal loans are typically charged off no later than 180 days delinquent.

For all loan types, when a loan is placed on nonaccrual status, all interest accrued but uncollected is reversed against interest income in the period in which the status is changed. Subsequent payments received from the customer are applied to principal and no further interest income is recognized until the principal has been paid in full or until circumstances have changed such that payments are again consistently received as contractually required. The Company occasionally recognizes income on a cash basis for non-accrual loans in which the collection of the remaining principal balance is not in doubt.

Impaired loans: A loan is considered impaired when, based on current information; it is probable that the Company will be unable to collect the scheduled payments of principal and/or interest under the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and/or interest payments. Loans that experience insignificant payment delays or payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays or payment shortfalls on a case-by-case basis. When determining the possibility of impairment, management considers the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. For collateral-dependent loans, the Company uses the fair value of collateral method to measure impairment. The collateral-dependent loans that recognize impairment are charged down to the fair value less costs to sell. All other loans are measured for impairment either based on the present value of future cash flows or the loan’s observable market price.

Troubled debt restructured loan (“TDR”): A TDR is a loan on which the Company, for reasons related to the borrower’s financial difficulties, grants a concession to the borrower that the Company would not otherwise consider. These concessions included but are not limited to term extensions, rate reductions and principal reductions. Forgiveness of principal is rarely granted and modifications for all classes of loans are predominately term extensions. A TDR loan is also considered impaired. Generally, a loan that is modified at an effective market rate of interest may no longer be disclosed as a troubled debt restructuring in years subsequent to the restructuring if it is not impaired based on the terms specified by the restructuring agreement.

Allowance for Loan Losses and Provision for Loan Losses

The Company maintains a detailed, systematic analysis and procedural discipline to determine the amount of the allowance for loan losses (“ALL”). The ALL is based on estimates and is intended to be appropriate to provide for probable losses inherent in the loan portfolio. This process involves deriving probable loss estimates that are based on migration analysis and historical loss rates, in addition to qualitative factors that are based on management’s judgment. The migration analysis and historical loss rate calculations are based on the annualized loss rates utilizing a twelve-quarter loss history. Migration analysis is utilized for the Commercial Real Estate (“CRE”), Commercial, Commercial Agriculture, Small Business Administration (“SBA”), Home Equity Line of Credit (“HELOC”), Single Family Residential, and Consumer portfolios. The historical loss rate method is utilized primarily for the Manufactured Housing portfolio. The migration analysis takes into account the risk rating of loans that are charged off in each loan category. Loans that are considered Doubtful are typically charged off. The following is a description of the characteristics of loan ratings. Loan ratings are reviewed as part of our normal loan monitoring process, but, at a minimum, updated on an annual basis.

Outstanding – This is the highest quality rating that is assigned to any loan in the portfolio. These loans are made to the highest quality borrowers with strong financial statements and unquestionable repayment sources. Collateral securing these types of credits are generally cash deposits in the bank or marketable securities held in custody.

Good – Loans rated in this category are strong loans, underwritten well, that bear little risk of loss to the Company. Loans in this category are loans to quality borrowers with very good financial statements that present an identifiable strong primary source and good secondary source of repayment. Generally, these credits are well collateralized by good quality and liquid assets or low loan to value market real estate.

Pass - Loans rated in this category are acceptable loans, appropriately underwritten, bearing an ordinary risk of loss to the Company. Loans in this category are loans to quality borrowers with financial statements presenting a good primary source as well as an adequate secondary source of repayment. In the case of individuals, borrowers with this rating are quality borrowers demonstrating a reasonable level of secure income, a net worth adequate to support the loan and presenting a good primary source as well as an adequate secondary source of repayment.

Watch – Acceptable credit that requires a temporary increase in attention by management. This can be caused by declines in sales, margins, liquidity or working capital. Generally the primary weakness is lack of current financial statements and industry issues.

Special Mention - A Special Mention loan has potential weaknesses that require management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

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Substandard - A Substandard loan is inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. These loans have a well-defined weakness or weaknesses that jeopardize full collection of amounts due. They are characterized by the distinct possibility that the Company will sustain some loss if the borrower's deficiencies are not corrected.

Doubtful - A loan classified Doubtful has all the weaknesses inherent in one classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans.

Loss - Loans classified Loss are considered uncollectible and of such little value that their continuance as bankable loans is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this loan even though partial recovery may be realized in the future. Losses are taken in the period in which they are considered uncollectible.

The Company's ALL is maintained at a level believed appropriate by management to absorb known and inherent probable losses on existing loans. The allowance is charged for losses when management believes that full recovery on the loan is unlikely. The following is the Company's policy regarding charging off loans.

Commercial, CRE and SBA Loans

Charge-offs on these loan categories are taken as soon as all or a portion of any loan balance is deemed to be uncollectible. A loan is considered impaired when, based on current information, it is probable that the Company will be unable to collect the scheduled payments of principal and/or interest under the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and/or interest payments. Loans that experience insignificant payment delays or payment shortfalls generally are not classified as impaired. Generally, loan balances are charged-down to the fair value of the collateral, if, based on a current assessment of the value, an apparent deficiency exists. In the event there is no perceived equity, the loan is charged-off in full. Unsecured loans which are delinquent over 90 days are also charged-off in full.

Single Family Real Estate, HELOC's and Manufactured Housing Loans

Consumer loans and residential mortgages secured by one-to-four family residential properties, HELOC and manufactured housing loans in which principal or interest is due and unpaid for 90 days, are evaluated for impairment. Loan balances are charged-off to the fair value of the property, less estimated selling costs, if, based on a current appraisal, an apparent deficiency exists. In the event there is no perceived equity, the loan is generally fully charged-off. Other consumer loans which are not secured and unpaid over 90-120 days are charged-off in full.

Consumer Loans

All consumer loans (excluding real estate mortgages, HELOCs and savings secured loans) are charged-off or charged-down to net recoverable value before becoming 120 days or five payments delinquent.

The ALL calculation for the different loan portfolios is as follows:

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- Commercial Real Estate, Commercial, Commercial Agriculture, SBA, HELOC, Single Family Residential, and Consumer – Migration analysis combined with risk rating is used to determine the required ALL for all non-impaired loans. In addition, the migration results are adjusted based upon qualitative factors that affect this specific portfolio category. Reserves on impaired loans are determined based upon the individual characteristics of the loan.
- Manufactured Housing – The ALL is calculated on the basis of loss history and risk rating, which is primarily a function of delinquency. In addition, the loss results are adjusted based upon qualitative factors that affect this specific portfolio.

The Company evaluates and individually assesses for impairment loans generally greater than $500,000, classified as substandard or doubtful in addition to loans either on nonaccrual, considered a TDR or when other conditions exist which lead management to review for possible impairment. Measurement of impairment on impaired loans is determined on a loan-by-loan basis and in total establishes a specific reserve for impaired loans. The amount of impairment is determined by comparing the recorded investment in each loan with its value measured by one of three methods:

- The expected future cash flows are estimated and then discounted at the effective interest rate.
- The value of the underlying collateral net of selling costs. Selling costs are estimated based on industry standards, the Company's actual experience or actual costs incurred as appropriate. When evaluating real estate collateral, the Company typically uses appraisals or valuations, no more than twelve months old at time of evaluation. When evaluating non-real estate collateral securing the loan, the Company will use audited financial statements or appraisals no more than twelve months old at time of evaluation. Additionally, for both real estate and non-real estate collateral, the Company may use other sources to determine value as deemed appropriate.
- The loan's observable market price.

Interest income is not recognized on impaired loans except for limited circumstances in which a loan, although impaired, continues to perform in accordance with the loan contract and the borrower provides financial information to support maintaining the loan on accrual.

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The Company determines the appropriate ALL on a monthly basis. Any differences between estimated and actual observed losses from the prior month are reflected in the current period in determining the appropriate ALL determination and adjusted as deemed necessary. The review of the appropriateness of the allowance takes into consideration such factors as concentrations of credit, changes in the growth, size and composition of the loan portfolio, overall and individual portfolio quality, review of specific problem loans, collateral, guarantees and economic and environmental conditions that may affect the borrowers' ability to pay and/or the value of the underlying collateral. Additional factors considered include: geographic location of borrowers, changes in the Company's product-specific credit policy and lending staff experience. These estimates depend on the outcome of future events and, therefore, contain inherent uncertainties.

Another component of the ALL considers qualitative factors related to non-impaired loans. The qualitative portion of the allowance on each of the loan pools is based on the following factors:

- Concentrations of credit
- International risk
- Trends in volume, maturity, and composition
- Volume and trend in delinquency
- Economic conditions
- Outside exams
- Geographic distance
- Policy and changes
- Staff experience and ability

Off Balance Sheet and Credit Exposure

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded. They involve, to varying degrees, elements of credit risk in excess of amounts recognized in the consolidated balance sheets. Losses would be experienced when the Company is contractually obligated to make a payment under these instruments and must seek repayment from the borrower, which may not be as financially sound in the current period as they were when the commitment was originally made. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Company enters into credit arrangements that generally provide for the termination of advances in the event of a covenant violation or other event of default. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the party. The commitments are collateralized by the same types of assets used as loan collateral.

As with outstanding loans, the Company applies qualitative factors and utilization rates to its off-balance sheet obligations in determining an estimate of losses inherent in these contractual obligations. The estimate for loan losses on off-balance sheet instruments is included within other liabilities and the charge to income that establishes this liability is included in non-interest expense.

Foreclosed Real Estate and Repossessed Assets

Foreclosed real estate and other repossessed assets are recorded at fair value at the time of foreclosure less estimated costs to sell. Any excess of loan balance over the fair value less estimated costs to sell of the other assets is charged-off against the allowance for loan losses. Any excess of the fair value less estimated costs to sell over the loan balance is recorded as a loan loss recovery to the extent of the loan loss previously charged-off against the allowance for loan losses; and, if greater, recorded as a gain on foreclosed assets. Subsequent to the legal ownership date, the Company periodically performs a new valuation and the asset is carried at the lower of carrying amount or fair value less estimated costs to sell. Operating expenses or income, and gains or losses on disposition of such properties, are recorded in current operations.

Income Taxes

The Company uses the asset and liability method, which recognizes an asset or liability representing the tax effects of future deductible or taxable amounts that have been recognized in the consolidated financial statements. Due to tax regulations, certain items of income and expense are recognized in different periods for tax return purposes than for financial statement reporting. These items represent “temporary differences.” Deferred income taxes are recognized for the tax effect of temporary differences between the tax basis of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. A valuation allowance is established for deferred tax assets if, based on weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets may not be realized. Any interest or penalties assessed by the taxing authorities is classified in the financial statements as income tax expense. Deferred tax assets are included in other assets on the consolidated balance sheets.

Management evaluates the Company’s deferred tax asset for recoverability using a consistent approach which considers the relative impact of negative and positive evidence, including the Company’s historical profitability and projections of future taxable income. The Company is required to establish a valuation allowance for deferred tax assets and record a charge to income if management determines, based on available evidence at the time the determination is made, that it is more likely than not that some portion or all of the deferred tax assets may not be realized.

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The Company is subject to the provisions of ASC 740, Income Taxes ("ASC 740"). ASC 740 prescribes a more likely than not threshold for the financial statement recognition of uncertain tax positions. ASC 740 clarifies the accounting for income taxes by prescribing a minimum recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. On a quarterly basis, the Company evaluates income tax accruals in accordance with ASC 740 guidance on uncertain tax positions.

Earnings Per Share

Basic earnings per common share is computed using the weighted average number of common shares outstanding for the period divided into the net income available to common shareholders. Diluted earnings per share include the effect of all dilutive potential common shares for the period. Potentially dilutive common shares include stock options and warrants.

Recent Accounting Pronouncements

In January 2014, the FASB issued guidance within ASU 2014-04, "Receivables - Troubled Debt Restructurings by Creditors: Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." The amendments in ASU 2014-04, Subtopic 310-40, Receivables -Troubled Debt Restructurings by Creditors, clarify that an in-substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure, or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. ASU 2014-04 was effective for the Company using either a modified retrospective transition method or a prospective transition method for reporting periods beginning after December 15, 2014. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued guidance codified within ASU 2014-09, "Revenue Recognition - Revenue from Contracts with Customers," which amends the guidance in former Topic 605, Revenue Recognition. The new revenue recognition standard will supersede virtually all revenue guidance in U.S. GAAP, including industry specific guidance. The guidance in this Update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards. ASU 2014-09 is effective for the Company for annual reporting periods beginning after December 15, 2016. In July 2015, this effective date was extended for the Company to December 18, 2017. The Company may elect to apply the amendments of this Update using one of the following two methods: 1) retrospectively to each prior reporting period presented or 2) retrospectively with the cumulative effect of initially applying this Update recognized at the date of initial application. The Company is currently evaluating the impact of the provisions in this standard on the Company's consolidated financial statements.

2. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities are as follows:

	September 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value

Securities available-for-sale	(in thousands)			
U.S. government agency notes	$11,293	$ 3	$ (66)	$11,230
U.S. government agency collateralized mortgage obligations ("CMO")	12,648	74	(48)	12,674
Equity securities: Farmer Mac class A stock	66	-	(14)	52
Total	$24,007	$ 77	$ (128)	$23,956
Securities held-to-maturity				
U.S. government agency mortgage backed securities ("MBS")	$7,245	$ 427	$ -	$7,672
Total	$7,245	$ 427	$ -	$7,672

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	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
Securities available-for-sale	(in thousands)			
U.S. government agency notes	$7,846	$ 65	$ (49)	$7,862
U.S. government agency collateralized mortgage obligations ("CMO")	14,229	73	(31)	14,271
Equity securities: Farmer Mac class A stock	66	-	(5)	61
Total	$22,141	$ 138	$ (85)	$22,194
Securities held-to-maturity				
U.S. government agency MBS	$8,447	$ 447	$ -	$8,894
Total	$8,447	$ 447	$ -	$8,894

At September 30, 2015 and December 31, 2014, $31.1 million and $30.6 million of securities at carrying value, respectively, were pledged to the Federal Home Loan Bank (“FHLB”), as collateral for current and future advances.

The maturity periods and weighted average yields of investment securities at September 30, 2015 and December 31, 2014 were as follows:

	September 30, 2015									
	Less than One Year		One to Five Years		Five to Ten Years		Over Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Securities available-for-sale	(dollars in thousands)									
U.S. government agency notes	$9,010	2.4 %	$-	-	$2,220	0.9 %	$-	-	$11,230	2.1 %
U.S. government agency CMO	-	-	5,232	1.2 %	4,036	0.6 %	3,406	1.1 %	12,674	1.0 %
Farmer Mac class A stock	-	-	-	-	-	-	-	-	52	-
Total	$9,010	2.4 %	$5,232	1.2 %	$6,256	0.7 %	$3,406	1.1 %	$23,956	1.5 %
Securities held-to-maturity										
U.S. government agency MBS	$-	-	$2,222	3.5 %	$5,023	2.9 %	$-	-	$7,245	3.1 %
Total	$-	-	$2,222	3.5 %	$5,023	2.9 %	$-	-	$7,245	3.1 %

	December 31, 2014									
	Less than One Year		One to Five Years		Five to Ten Years		Over Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Securities available-for-sale	(dollars in thousands)									
U.S. government agency notes	$7,862	2.5 %	$-	-	$-	-	$-	-	$7,862	2.5 %
U.S. government agency CMO	-	-	7,826	1.0 %	2,801	0.6 %	3,644	1.1 %	14,271	1.1 %
Farmer Mac class A stock	-	-	-	-	-	-	-	-	61	-
Total	$7,862	2.5								