UNITED SECURITY BANCSHARES
Form 10-K
March 31, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2009.

o 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: 000-32987

UNITED SECURITY BANCSHARES
(Exact name of registrant as specified in its charter)

CALIFORNIA (State or other jurisdiction of incorporation or organization)	91-2112732 (I.R.S. Employer Identification No.)
2126 Inyo Street, Fresno, California (Address of principal executive offices)	93721 (Zip Code)

Registrant’s telephone number, including area code (559) 248-4943

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, no par value on Nasdaq
(Title of Class)

Securities registered pursuant to Section 12(g) of the Act: NONE

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Act.
Yes o No x

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 for the past 90 days.
Yes x No o

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 o No o

Indicate by check mark if disclosure of delinquent filers pursuant to item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrants knowledge, in the definitive proxy or information statements incorporated by reference in Part III of this form 10-K or any amendment to this Form 10-K. o

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 the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer o Non-accelerated filer x Small reporting company o

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

Aggregate market value of the Common Stock held by non-affiliates as of the last business day of the registrant's most recently completed second fiscal quarter - June 30, 2009: $43,114,654

Shares outstanding as of February 28, 2009: 12,496,499

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the Definitive Proxy Statement for the 2010 Meeting of Shareholders is incorporated by reference into Part III. Part III, Items 10, 11, 12, 13 and 14

UNITED SECURITY BANCSHARES
TABLE OF CONTENTS

PART I:	
Item 1 - Business	3
Item 1A – Risk Factors	18
Item 1B – Unresolved Staff Comments	23
Item 2 - Properties	23
Item 3 - Legal Proceedings	26
Item 4 – (Reserved)	26
PART II:	
Item 5 - Market for the Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities	27
Item 6 - Selected Financial Data	30
Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations	31
Item 7A - Quantitative and Qualitative Disclosure About Market Risk	69
Item 8 - Financial Statements and Supplementary Data	72
Item 9 - Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	111
Item 9A(T) – Controls and Procedures	111
Item 9B – Other Information	113
PART III:	
Item 10 – Directors, Executive Officers, and Corporate Governance	113
Item 11 - Executive Compensation	113
Item 12 - Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	113
Item 13 - Certain Relationships and Related Transactions, and Director Independence	113
Item 14 – Principal Accounting Fees and Services	113
PART IV:	
Item 15 – Exhibits and Financial Statement Schedules	114

PART 1

Certain matters discussed or incorporated by reference in this Annual Report of Form 10-K including, but not limited to, those described in "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations", are forward-looking statements as defined under the Securities Litigation Reform Act of 1995 that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Such risks and uncertainties include, among others, (1) competitive pressure in the banking industry increases significantly; (2) changes in the interest rate environment which may reduce margins and devalue assets; (3) general economic conditions, either nationally or regionally, are less favorable than expected, resulting in, among other things, a deterioration in credit quality; (4) changes in the regulatory environment; (5) changes in business conditions and inflation; (6) changes in securities markets; (7) asset/liability matching risks and liquidity risks; (8) potential impairment of goodwill and other intangible assets; (9) loss of key personnel; and (10) operational interruptions including data processing systems failure and fraud. Therefore, the information set forth therein should be carefully considered when evaluating the business prospects of the Company.

Item 1 - Business

General

United Security Bancshares (the “Company”) is a California corporation incorporated during March of 2001 and is registered with the Board of Governors of the Federal Reserve System as a bank holding company under the Bank Holding Company Act of 1956, as amended. The Company’s stock is listed on NASDAQ under the symbol “UBFO”. United Security Bank (the “Bank”) is a wholly-owned bank subsidiary of the Company and was formed in 1987. United Security Bancshares Capital Trust I (the “Trust”) was formed during June of 2001 as a Delaware business trust for the sole purpose of issuing Trust Preferred securities. The Trust was originally formed as a subsidiary of the Company, but was deconsolidated during 2004 pursuant to the adoption of FIN 46 (as revised), “Consolidation of Variable Interest Entities”. During July 2007, the Trust Preferred Securities issued under USB Capital Trust I were redeemed, and upon retirement, the USB Capital Trust I was dissolved. During July the Company formed United Security Bancshares Capital Trust II and issued $15.0 million in Trust Preferred Securities with terms similar to those originally issued under USB Capital Trust I, except at a lower interest rate. At present, the Company does not engage in any material business activities other than ownership of the Bank.

United Security Bank

On June 12, 2001, the Bank became the wholly owned subsidiary of United Security Bancshares, through a tax-free holding company reorganization, accounted for on a basis similar to the pooling of interest method. In the transaction, each share of Bank stock was exchanged for a share of Company stock on a one-to-one basis.

The Bank is a California state-chartered bank headquartered in Fresno, California. It is also a member of the Federal Reserve System (“Fed member”). The Bank originally commenced business on December 21, 1987 as a national bank and, during the fourth quarter of 1998, filed an application with the California Department of Financial Institutions and other regulatory authorities to become a state-chartered bank. The shareholders approved the conversion in January of 1999, and the Bank was granted approval to operate as a state-chartered bank on February 3, 1999. The Bank’s operations are currently subject to federal and state laws applicable to state-chartered, Fed member banks and its deposits are insured up to the applicable limits by the Federal Deposit Insurance Corporation (the "FDIC"). The Bank is also subject to the Federal Deposit Insurance Act and regulatory reporting requirements of the FDIC. As a state-chartered bank and a member of the Federal Reserve System, the Bank is subject to supervision and regular examinations by the Board of Governors of the Federal Reserve System (the “FRB”) and the California Department of Financial Institutions (the “DFI”). In addition, the Bank is required to file reports with the FRB and provide such additional information as the FRB may require.

USB Investment Trust Inc. was incorporated effective December 31, 2001 as a special purpose real estate investment trust ("REIT") under Maryland law. The REIT is a subsidiary of the Bank and was funded with $133.0 million in real estate-secured loans contributed by the Bank. USB Investment Trust was originally formed to give the Bank flexibility in raising capital, and reduce the expenses associated with holding the assets contributed to USB Investment Trust. For further discussion of the REIT, refer to Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations – Income Taxes.

Effective April 23, 2004, the Company completed a merger with Taft National Bank headquartered in Taft, California. Taft National Bank ("Taft") was merged into United Security Bank and Taft's two branches operate as branches of United Security Bank. The total consideration paid to Taft shareholders was 241,447 shares of the Company's Common Stock valued at just over $6 million. In the merger, the Company acquired $15.4 million in cash and short-term investments, $23.3 million in loans, and $48.2 million in deposits. This transaction was accounted for using the purchase method of accounting, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Taft based on the fair value of those assets and liabilities.

On February 16, 2007, the Company completed its merger with Legacy Bank, N.A., located in Campbell, California, with the acquisition of 100 percent of Legacy's outstanding common shares. At merger, Legacy Bank's one branch was merged with and into United Security Bank, a subsidiary of the Company. The total value of the merger transaction was $21.5 million, and the shareholders of Legacy Bank received merger consideration consisting of 976,411 shares of common stock of the Company. The merger transaction was accounted for as a purchase transaction, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Legacy Bank based on the fair value of those assets and liabilities. The net of assets acquired and liabilities assumed totaled approximately $8.6 million at the date of the merger. Fair value of Legacy assets and liabilities acquired, and resultant goodwill, has been determined and recorded as of the date of the merger and the resulting operations thereafter have been included in the consolidated financial statements.

During November 2007, the Company purchased the recurring contractual revenue stream and certain fixed assets from ICG Financial, LLC. Additionally, the Company hired all but one of the former employees of ICG Financial, LLC and its subsidiaries. The total purchase price was $414,000 including $378,000 for the recurring revenue stream and $36,000 for the fixed assets. A newly formed department of the Bank, USB Financial Services provides wealth management, employee benefit, insurance and loan products, as well as consulting services for a variety of clients, utilizing employees hired from ICG Financial LLC. The Company believes the wealth management and related services provided by USB Financial Services will enhance the products and services offered by the Company, and increase noninterest income. The original capitalized cost of $378,000 for the recurring contractual revenue stream is being amortized over a period of approximately three years.

At December 31, 2009, the Bank operates three branches (including its main office), one construction lending office, and one financial services office in Fresno and one branch each, in Oakhurst, Caruthers, San Joaquin, Firebaugh, Coalinga, Bakersfield, and Taft. In addition, the Company and Bank have administrative headquarters located at 2126 Inyo Street, Fresno, California, 93721.

At December 31, 2009, the consolidated Company had approximately $692.6 million in total assets, $492.7 million in net loans, $561.7 million in deposits, and $75.8 million in shareholders' equity.

The following discussion of the Company's services should be read in conjunction with "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS."

Bank Services

As a state-chartered commercial bank, United Security Bank offers a full range of commercial banking services primarily to the business and professional community and individuals located in Fresno, Madera, Kern, and Santa Clara Counties.

The Bank offers a wide range of deposit instruments including personal and business checking accounts and savings accounts, interest-bearing negotiable order of withdrawal ("NOW") accounts, money market accounts and time certificates of deposit. Most of the Bank's deposits are attracted from individuals and from small and medium-sized business-related sources.

The Bank also engages in a full complement of lending activities, including real estate mortgage, commercial and industrial, real estate construction, as well as agricultural, lease financing, and consumer loans, with particular emphasis on short and medium-term obligations. The Bank's loan portfolio is not concentrated in any one industry, although approximately 68% of the Bank's loans are secured by real estate. A loan may be secured (in whole or in part) by real estate even though the purpose of the loan is not to facilitate the purchase or development of real estate. At December 31, 2009, the Bank had loans (net of unearned fees) outstanding of $507.7 million, which represented approximately 90% of the Bank's total deposits and approximately 73% of its total assets.

Real estate mortgage loans are secured by deeds of trust primarily on commercial property. Repayment of real estate mortgage loans is generally from the cash flow of the borrower. Commercial and industrial loans have a high degree of industry diversification. Loans may be originated in the Company’s market area, or participated with other financial institutions outside the Company’s market area. A substantial portion of commercial and industrial loans are secured by accounts receivable, inventory, leases or other collateral. The remainder are unsecured; however extensions of credit are predicated on the financial capacity of the borrower to repay the extension of credit. Repayment of commercial loans is generally from the cash flow of the borrower. Real estate construction loans consist of loans to residential contractors, which are secured by single-family residential properties. All real estate loans have established equity requirements. Repayment of real estate construction loans is generally from long-term mortgages with other lending institutions. Agricultural loans are generally secured by land, equipment, inventory and receivables. Repayment of agricultural loans is from the expected cash flow of the borrower.

In the normal course of business, the Bank makes various loan commitments and incurs certain contingent liabilities. At December 31, 2009 and 2008, loan commitments of the Bank totaled $84.0 million and $112.3 million, respectively, and letters of credit totaled $4.0 million and $7.1 million, respectively. Of the $84.0 million in loan commitments outstanding at December 31, 2009, $65.4 million or 77.9% were for loans with maturities of one year or less. Due to the nature of the business of the Bank's customers, there are no seasonal patterns or absolute predictability to the utilization of unused loan commitments; therefore the Bank is unable to forecast the extent to which these commitments will be exercised within the current year. The Bank does not believe that any such utilization will constitute a material liquidity demand. The Company does however have collateralized and uncollateralized lines of credit which could be utilized if such loan commitments were to be exercised in excess of normal expectations.

In addition to the loan and deposit services discussed above, the Bank also offers a wide range of specialized services designed to attract and service the needs of commercial customers and account holders. These services include online banking, safe deposit boxes, ATM services, payroll direct deposit, cashier's checks, traveler's checks, money orders, and foreign drafts. In addition, the Bank offers a variety of specialized financial services, including wealth management, employee benefit, insurance and loan products, as well as consulting services for a variety of clients. The Bank does not operate a trust department; however, it makes arrangements with its correspondent bank to offer trust services to its customers on request. Most of the Bank's business originates within Fresno, Madera, Kern, and Santa Clara Counties. Neither the Bank’s business or liquidity is seasonal, and there has been no material effect upon the Bank's capital expenditures, earnings or competitive position as a result of federal, state or local environmental regulation.

Competition and Market Share

The banking business in California generally, and in the market area served by the Company specifically, is highly competitive with respect to both loans and deposits. The Company competes for loans and deposits with other commercial banks, savings and loan associations, finance companies, money market funds, credit unions and other financial institutions, including a number that are substantially larger than the Company. Deregulation of the banking industry, increased competition from non-bank entities for the cash balances of individuals and businesses, and continuing developments in the computer and communications industries have had, and most likely will continue to have, a significant impact on the Company's competitive position. With the enactment of interstate banking legislation in California, bank holding companies headquartered outside of California will continue to enter the California market and provide competition for the Company. Additionally, with the Gramm-Leach-Bliley Act of 1999, traditional competitive barriers between insurance companies, securities underwriters, and commercial banks have been eased, allowing a greater number of financial intermediaries to offer a wider assortment of financial services. Many of the major commercial banks operating in the Company's market areas offer certain services such as trust and international banking services, which the Company does not offer directly. In addition, banks with larger capitalization have larger lending limits and are thereby able to serve larger customers.

The Company’s primary market area at December 31, 2009 was located in Fresno, Madera, and Kern Counties, in which approximately 33 FDIC-insured financial institutions compete for business. Santa Clara County was added during February 2007 with the Legacy Bank acquisition, in which approximately 55 FDIC-insured financial institutions compete for business. The following table sets forth information regarding deposit market share and ranking by county as of June 30, 2009, which is the most current information available.

	Rank	Share
Fresno County	9th	4.17%
Madera County	9th	4.02%
Kern County	13th	1.15%

Total of Fresno, Madera, Kern Counties	10th	3.10%
Santa Clara County	46th	0.04%

Supervision and Regulation

The Company

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the “BHC Act”), and is registered as such with the FRB. A bank holding company is required to file with the FRB annual reports and other information regarding its business operations and those of its subsidiaries and is also subject to examination by the FRB.

The BHC Act requires, among other things, prior approval before acquiring, directly or indirectly, ownership or control of any voting shares of any bank, if after such acquisition it would directly or indirectly own or control more than 5% of the voting stock of that bank, unless it already owns a majority of the voting stock of that bank. The BHC Act also provides that the FRB shall not approve any acquisition that would result in or further the creation of a monopoly, or the effect of which may be substantially to lessen competition, unless the anticompetitive effects of the proposed transaction are clearly outweighed by the probable effect in meeting the convenience and needs of the community served.

Furthermore, under the BHC Act, a bank holding company is, with limited exceptions, prohibited from (i) acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or (ii) engaging in any activity other than managing or controlling banks. With the prior approval of the FRB, however, a bank holding company may own shares of a company engaged in activities which the FRB has determined to be so closely related to banking or managing or controlling banks as to be proper incident thereto. Amendments to the BHC Act expand the circumstances under which a bank holding company may acquire control of all or substantially all of the assets of a bank located outside the State of California.

The BHC Act requires a bank holding company to serve as a source of financial and managerial strength to its subsidiary banks. It is the FRB’s policy that a bank holding company should stand ready to use available resources to provide adequate capital funds to subsidiary banks during periods of financial stress and should maintain the financial flexibility and capital raising capacity to obtain additional resources for assisting a subsidiary bank. Under certain conditions, the FRB may conclude that certain actions of a bank holding company, such as payment of cash dividends, would constitute unsafe and unsound banking practices because they violate the FRB’s “source of strength” doctrine.

A bank holding company and its subsidiaries are prohibited from certain tie-in arrangements in connection with any extension of credit, sale or lease of property or furnishing of services. For example, with certain exceptions, a bank may not condition an extension of credit on a promise by its customer to obtain other services by it, its holding company or other subsidiaries, or on a promise by its customer not to obtain services from a competitor. In addition, federal law imposes certain restrictions between the Company and its subsidiaries, including the Bank. As an affiliate of the Bank, the Company is subject, with certain exceptions, to provisions of federal law imposing limitations on, and requiring collateral for, extensions of credit by the Bank to its affiliates.

As a public company, United Security Bancshares is subject to the Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act amends the Securities and Exchange Act of 1934, and is intended to protect investors by, among other things, improving the reliability of financial reporting, increasing management accountability, and increasing the independence of Directors and the Company’s external accountants.

The Company is subject to the periodic reporting requirements of the Securities Exchange Act of 1934, as amended, which include but are not limited to the filing of annual, quarterly and other current reports with the SEC.

The Bank

The Bank as a state-chartered bank is subject to regulation, supervision and regular examination by the California Department of Financial Institutions. In addition, The Bank is also a member of the Federal Reserve System and, as such, is subject to applicable provisions of the Federal Reserve Act and regulations issued thereunder and, is subject to regulation, supervision and regular examination by the Federal Reserve Bank. The Bank is subject to California law, insofar as they are not preempted by federal banking law. Deposits of the Bank are insured by the FDIC up to the applicable limits in an amount up to $250,000 per customer, and, as such, the Bank is subject to the regulations of the FDIC and the Federal Deposit Insurance Act. As a consequence of the extensive regulation of commercial banking activities in California and the United States, the Bank’s business is particularly susceptible to changes in California and federal legislation and regulation, which may have the effect of increasing the cost of doing business, limiting permissible activities or increasing competition.

Various other requirements and restrictions under the laws of the United States and the State of California affect the operations of the Bank. Federal and California statutes and regulations relate to many aspects of the Bank’s operations, including capital requirements and disclosure requirements to depositors and borrowers, requirements to maintain reserves against deposits, limitations on interest rates payable on deposits, loans, investments, and restrictions on borrowings and on payment of dividends. The DFI regulates the number and location of branch offices of a state-chartered bank, and may permit a bank to maintain branches only to the extent allowable under state law for state banks. California law presently permits a bank to locate a branch in any locality in the state. Additionally, California law exempts banks from California usury laws.

Capital Standards. The FRB has risk-based capital adequacy guidelines intended to provide a measure of capital adequacy that reflects the degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets, and transactions, such as letters of credit and recourse arrangements, which are reported as off-balance-sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off-balance-sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as certain U.S. government securities, to 100% for assets with relatively higher credit risk, such as business loans.

A banking organization's risk-based capital ratios are obtained by dividing its qualifying capital by its total risk-adjusted assets and off-balance-sheet items. The regulators measure risk-adjusted assets and off-balance-sheet items against both total qualifying capital (the sum of Tier 1 capital and limited amounts of Tier 2 capital) and Tier 1 capital. Tier 1 capital consists of common stock, retained earnings, noncumulative perpetual preferred stock and minority interests in certain subsidiaries, less most other intangible assets. Tier 2 capital may consist of a limited amount of the allowance for loan and lease losses and certain other instruments with some characteristics of equity. The inclusion of elements of Tier 2 capital is subject to certain other requirements and limitations of the federal banking agencies. Since December 31, 1992, the FRB and the FDIC have required a minimum ratio of qualifying total capital to risk-adjusted assets and off-balance-sheet items of 8%, and a minimum ratio of Tier 1 capital to risk-adjusted assets and off-balance-sheet items of 4%.

In addition to the risk-based guidelines, the FRB requires banking organizations to maintain a minimum amount of Tier 1 capital to average total assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets is 3%. It is improbable; however, that an institution with a 3% leverage ratio would receive the highest rating by the regulators since a strong capital position is a significant part of the regulators' ratings. For all banking organizations not rated in the highest category, the minimum leverage ratio is at least 100 to 200 basis points above the 3% minimum. Thus, the effective minimum leverage ratio, for all practical purposes, is at least 4% or 5%. In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the FRB and FDIC have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios.

A bank that does not achieve and maintain the required capital levels may be issued a capital directive by the FDIC to ensure the maintenance of required capital levels. As discussed above, we are required to maintain certain levels of capital, as is the Bank. The regulatory capital guidelines as well as the actual capitalization for the Bank and the Company as of December 31, 2009 follow:

	Requirement for the Bank to be:			
	Adequately Capitalized	Well Capitalized	Company	Bank
Tier 1 leverage capital ratio	4.0%	5.0%	11.68%	11.19%
Tier 1 risk-based capital ratio	4.0%	6.0%	13.03%	12.47%
Total risk-based capital ratio	8.0%	10.0%	14.30%	13.70%

Prompt Corrective Action. Federal banking agencies possess broad powers to take corrective and other supervisory action to resolve the problems of insured depository institutions, including those institutions that fall below one or more prescribed minimum capital ratios described above. An institution that, based upon its capital levels, is classified as well capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions.

In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the federal regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation, or any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include the imposition of a conservator or receiver, the issuance of a cease-and-desist order that can be judicially enforced, the termination of insurance of deposits (in the case of a depository institution), the imposition of civil money penalties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the issuance of removal and prohibition orders against institution-affiliated parties and the enforcement of such actions through injunctions or restraining orders based upon a judicial determination that the agency would be harmed if such equitable relief was not granted. Additionally, a holding company’s inability to serve as a source of strength to its subsidiary banking organizations could serve as an additional basis for a regulatory action against the holding company.

Premiums for Deposit Insurance. The deposit insurance fund of the FDIC insures our customer deposits up to prescribed limits for each depositor. The Federal Deposit Insurance Reform Act of 2005 and the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 amended the insurance of deposits by the FDIC and collection of assessments from insured depository institutions for deposit insurance. The FDIC approved a final rule in 2006 and amended the rule in February 2009 that sets an insured depository institution's assessment rate on different factors that pose a risk of loss to the Deposit Insurance Fund, including the institution's recent financial ratios and supervisory ratings, and level of reliance on a significant amount of secured liabilities or significant amount of brokered deposits (except that the factor of brokered deposits will not be considered for well capitalized institutions that are not accompanied by rapid growth). The FDIC also in February 2009 set the assessment base rates to range between $0.12 to $0.16 per $100 of insured deposits on an annual basis. In May 2009, the FDIC imposed a special assessment of 5 basis points on each insured depository institution's assets less its Tier 1 capital payable on September 30, 2009 with a ceiling of 10 basis points of an institution's domestic deposits. In November 2009, the FDIC approved a final rule to require all insured depository institutions including the Bank to prepay three years of FDIC assessments in the fourth quarter of 2009, except in the event such prepayment is waived by the FDIC. The prepayment provision was waived for the Bank by the FDIC. Although the Bank was exempted from the three-year prepayment assessment, amounts paid and expensed for the quarterly FDIC insurance assessment increased significantly during 2009 and may reduce the cash and liquidity of the Bank in subsequent periods. Due to the significant losses at failed banks and expected losses for banks that will fail, it is likely that FDIC insurance fund assessments on the Bank will increase, and such assessments may materially adversely affect the profitability of the Bank.

Any increase in assessments or the assessment rate could have a material adverse effect on our business, financial condition, results of operations or cash flows, depending on the amount of the increase. Furthermore, the FDIC is authorized to raise insurance premiums under certain circumstances.

The FDIC is authorized to terminate a depository institution's deposit insurance upon a finding by the FDIC that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the institution's regulatory agency. The termination of deposit insurance for the bank would have a material adverse effect on our business, financial condition, results of operations and/or cash flows.

Federal Home Loan Bank System. The Bank is a member of the Federal Home Loan Bank of San Francisco (the "FHLB-SF"). Among other benefits, each Federal Home Loan Bank ("FHLB") serves as a reserve or central bank for its members within its assigned region. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. Each FHLB makes available loans or advances to its members in compliance with the policies and procedures established by the Board of Directors of the individual FHLB. The FHLB-SF utilizes a single class of stock with a par value of $100 per share, which may be issued, exchanged, redeemed and repurchased only at par value. As an FHLB member, the Bank is required to own FHLB –SF capital stock in an amount equal to the greater of:

- a membership stock requirement with an initial cap of $25 million (100% of "membership asset value" as defined), or
- an activity based stock requirement (based on percentage of outstanding advances).

The FHLB – SF capital stock is redeemable on five years written notice, subject to certain conditions. At December 31, 2009 the Bank owned 41,595 shares of the FHLB-SF capital stock.

Federal Reserve. The FRB requires all depository institutions to maintain non-interest bearing reserves at specified levels against their transaction accounts and non-personal time deposits. At December 31, 2009, we were in compliance with these requirements.

Regulatory Action

Effective March 23, 2010, United Security Bancshares (the "Company") and its wholly owned subsidiary, United Security Bank (the "Bank"), entered into a written agreement with the Federal Reserve Bank of San Francisco. Under the terms of the agreement, the Company and the Bank agreed, among other things, to strengthen board oversight of management and the Bank's operations; submit an enhanced written plan to strengthen credit risk management practices and improve the Bank’s position on the past due loans, classified loans, and other real estate owned; maintain a sound process for determining, documenting, and recording an adequate allowance for loan and lease losses; improve the management of the Bank's liquidity position and funds management policies; maintain sufficient capital at the Company and Bank level; and improve the Bank’s earnings and overall condition. The Company and Bank have also agreed not to increase or guarantee any debt, purchase or redeem any shares of stock, declare or pay any cash dividends, or pay interest on the Company's junior subordinated debt or trust preferred securities, without prior written approval from the Federal Reserve Bank.

This agreement was a result of a regulatory examination that was conducted by the Federal Reserve and the California Department of Financial Institutions in June 2009, and relates primarily to the Bank's asset quality. Progress on these items has been made since the completion of the examination and management and the Board are committed to resolving all of the items addressed by the Federal Reserve in the agreement. Both the Company and the Bank will submit quarterly written progress reports to the Federal Reserve Bank.

The Company and the Bank have also received notification from the California Department of Financial Institutions of their intention to issue a regulatory order as a result of the June 2009 regulatory examination. The Company and the Bank have not yet entered into an agreement with the California Department of Financial Institutions, but believe that any agreement entered into, will be similar to the current agreement with the Federal Reserve Bank of San Francisco.

Effect of Governmental Policies and Recent Legislation

Banking has traditionally been a business that depends on rate differentials. In general, the difference between the interest rate paid by the Company on its deposits and other borrowings and the interest rate received on loans extended to its customers and securities held in the Company's portfolio comprise the major portion of the Company's earnings. These rates are highly sensitive to many factors which are beyond the control of the Company. Accordingly, the earnings and growth of the Company are subject to the influence of domestic and foreign economic conditions, including, but not limited to, inflation, recession and unemployment.

Impact of Monetary Policies. The earnings and growth of the Company are affected not only by general economic conditions, both domestic and foreign, but also by the monetary and fiscal policies of the United States government and its agencies, particularly the Federal Reserve Board ("FRB"). The FRB implements national monetary policies (with objectives such as to curb inflation and combat recession) by its open market operations in United States Government securities, by adjusting the required level of reserves for financial institutions subject to reserve requirements, and by varying the discount rates applicable to borrowing by banks which are members of the Federal Reserve System. The actions of the FRB in these areas influence the growth of bank loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. The FRB's policies have had a significant effect on the operating results of commercial banks and are expected to continue to do so in the future. The nature and timing of any future changes in monetary policies are not predictable. In addition, adverse economic conditions could make a higher provision for loan losses a prudent course and could cause higher loan charge-offs, thus adversely affecting the Company's net income.

Extensions of Credit to Insiders and Transactions with Affiliates. The Federal Reserve Act and FRB Regulation O place limitations and conditions on loans or extensions of credit to:

- a bank's or bank holding company's executive officers, directors and principal shareholders (i.e., in most cases, those persons who own, control or have power to vote more than 10% of any class of voting securities),
- any company controlled by any such executive officer, director or shareholder, or
- any political or campaign committee controlled by such executive officer, director or principal shareholder.

Loans and leases extended to any of the above persons must comply with loan-to-one-borrower limits, require prior full board approval when aggregate extensions of credit to the person exceed specified amounts, must be made on substantially the same terms (including interest rates and collateral) as, and follow credit-underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions with non-insiders, and must not involve more than the normal risk of repayment or present other unfavorable features. In addition, Regulation O provides that the aggregate limit on extensions of credit to all insiders of a bank as a group cannot exceed the bank's unimpaired capital and unimpaired surplus. Regulation O also prohibits a bank from paying an overdraft on an account of an executive officer or director, except pursuant to a written pre-authorized interest-bearing extension of credit plan that specifies a method of repayment or a written pre-authorized transfer of funds from another account of the officer or director at the bank.

Consumer Protection Laws and Regulations. The banking regulatory agencies are focusing greater attention on compliance with consumer protection laws and their implementing regulations. Examination and enforcement have become more intense in nature, and insured institutions have been advised to monitor carefully compliance with such laws and regulations. The Company is subject to many federal and state consumer protection and privacy statutes and regulations, some of which are discussed below.

The Community Reinvestment Act (the “CRA”) is intended to encourage insured depository institutions, while operating safely and soundly, to help meet the credit needs of their communities. The CRA specifically directs the federal regulatory agencies, in examining insured depository institutions, to assess a bank’s record of helping meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. The CRA further requires the agencies to take a financial institution’s record of meeting its community credit needs into account when evaluating applications for, among other things, domestic branches, mergers or acquisitions, or holding company formations. The agencies use the CRA assessment factors in order to provide a rating to the financial institution. The ratings range from a high of “outstanding” to a low of “substantial noncompliance.” In its last examination for CRA compliance, as of August 2005, the Bank was rated “satisfactory.”

The Equal Credit Opportunity Act (the “ECOA”) generally prohibits discrimination in any credit transaction, whether for consumer or business purposes, on the basis of race, color, religion, national origin, sex, marital status, age (except in limited circumstances), receipt of income from public assistance programs, or good faith exercise of any rights under the Consumer Credit Protection Act.

The Truth in Lending Act (the “TILA”) is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably. As a result of the TILA, all creditors must use the same credit terminology to express rates and payments, including the annual percentage rate, the finance charge, the amount financed, the total of payments and the payment schedule, among other things.

The Fair Housing Act (the “FH Act”) regulates many practices, including making it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status. A number of lending practices have been found by the courts to be, or may be considered, illegal under the FH Act, including some that are not specifically mentioned in the FH Act itself.

The Home Mortgage Disclosure Act (the “HMDA”), in response to public concern over credit shortages in certain urban neighborhoods, requires public disclosure of information that shows whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. The HMDA also includes a "fair lending" aspect that requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes.

The Right to Financial Privacy Act (the “RFPA”) imposes a new requirement for financial institutions to provide new privacy protections to consumers. Financial institutions must provide disclosures to consumers of its privacy policy, and state the rights of consumers to direct their financial institution not to share their nonpublic personal information with third parties.

Finally, the Real Estate Settlement Procedures Act (the “RESPA”) requires lenders to provide noncommercial borrowers with disclosures regarding the nature and cost of real estate settlements. Also, RESPA prohibits certain abusive practices, such as kickbacks, and places limitations on the amount of escrow accounts.

Penalties for noncompliance or violations under the above laws may include fines, reimbursement and other penalties. Due to heightened regulatory concern related to compliance with CRA, ECOA, TILA, FH Act, HMDA, RFPA and RESPA generally, the Company may incur additional compliance costs or be required to expend additional funds for investments in its local communities.

From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial institutions. Proposals to change the laws and regulations governing the operations and taxation of banks and other financial institutions are frequently made in Congress, in the California legislature and before various bank regulatory agencies.

The likelihood of any major change and the impact such change may have on the Company is impossible to predict. Certain of the potentially significant changes which have been enacted recently and other which are currently under consideration by Congress or various regulatory agencies or professional agencies are discussed below.

Recent Legislation and Other Changes

Federal and state laws affecting banking are enacted from time to time, and similarly federal and state regulations affecting banking are also adopted from time to time. The following include some of the recent laws and regulations affecting banking.

In May 2009 the Helping Families Save Their Homes Act of 2009 was enacted to help consumers avoid mortgage foreclosures on their homes through certain loss mitigation actions including special forbearance, loan modification, pre-foreclosure sale, deed in lieu of foreclosure, support for borrower housing counseling, subordinate lien resolution, and borrower relocation. The new law permits the Secretary of Housing and Urban Development (HUD), for mortgages either in default or facing imminent default, to: (1) authorize the modification of such mortgages; and (2) establish a program for payment of a partial claim to a mortgagee who agrees to apply the claim amount to payment of a mortgage on a 1- to 4-family residence. In implementing the law, the Secretary of HUD is authorized to (1) provide compensation to the mortgagee for lost income on monthly mortgage payments due to interest rate reduction; (2) reimburse the mortgagee from a guaranty fund in connection with activities that the mortgagee is required to undertake concerning repayment by the mortgagor of the amount owed to HUD; (3) make payments to the mortgagee on behalf of the borrower, under terms defined by HUD; and (4) make mortgage modification with terms extended up to 40 years from the modification date. The new law also authorizes the Secretary of HUD to: (1) reassign the mortgage to the mortgagee; (2) act as a Government National Mortgage Association (GNMA, or Ginnie Mae) issuer, or contract with an entity for such purpose, in order to pool the mortgage into a Ginnie Mae security; or (3) resell the mortgage in accordance with any program established for purchase by the federal government of insured mortgages. The new law also amends the Foreclosure Prevention Act of 2008, with respect to emergency assistance for the redevelopment of abandoned and foreclosed homes (neighborhood stabilization), to authorize each state that has received certain minimum allocations and has fulfilled certain requirements, to distribute any remaining amounts to areas with homeowners at risk of foreclosure or in foreclosure without regard to the percentage of home foreclosures in such areas.

Also in May 2009, the Credit Card Act of 2009 was enacted to help consumers and ban certain practices of credit card issuers. The new law allows interest rate hikes on existing balances only under limited conditions, such as when a promotional rate ends, there is a variable rate or if the cardholder makes a late payment. Interest rates on new transactions can increase only after the first year. Significant changes in terms on accounts cannot occur without 45 days' advance notice of the change. The new law bans raising interest rates on customers based on their payment records with other unrelated credit issuers (such as utility companies and other creditors) for existing credit card balances, though card issuers would still be allowed to use universal default on future credit card balances if they give at least 45 days' advance notice of the change. The new law allows consumers to opt out of certain significant changes in terms on their accounts. Opting out means cardholders agree to close their accounts and pay off the balance under the old terms. They have at least five years to pay the balance. Credit card issuers will be banned from issuing credit cards to anyone under 21, unless they have adult co-signers on the accounts or can show proof they have enough income to repay the card debt. Credit card companies must stay at least 1,000 feet from college campuses if they are offering free pizza or other gifts to entice students to apply for credit cards.

The new law requires card issuers to give card account holders "a reasonable amount of time" to make payments on monthly bills. That means payments would be due at least 21 days after they are mailed or delivered. Credit card issuers would no longer be able to set early morning or other arbitrary deadlines for payments. When consumers have accounts that carry different interest rates for different types of purchases payments in excess of the minimum amount due must go to balances with higher interest rates first. Consumers must "opt in" to over-limit fees. Those who opt out would have their transactions rejected if they exceed their credit limits, thus avoiding over-limit fees. Fees charged for going over the limit must be reasonable. Finance charges on outstanding credit card balances would be computed based on purchases made in the current cycle rather than going back to the previous billing cycle to calculate interest charges. Fees on credit cards cannot exceed 25 percent of the available credit limit in the first year of the card. Credit card issuers must disclose to cardholders the consequences of making only minimum payments each month, namely how long it would take to pay off the entire balance if users only made the minimum monthly payment. Issuers must also provide information on how much users must pay each month if they want to pay off their balances in 36 months, including the amount of interest.

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (“ARRA”) was enacted to provide stimulus to the struggling US economy. ARRA authorizes spending of $787 billion, including about $288 billion for tax relief, $144 billion for state and local relief aid, and $111 billion for infrastructure and science. In addition, ARRA includes additional executive compensation restrictions for recipients of funds from the US Treasury under the Troubled Assets Relief Program of the Emergency Economic Stimulus Act of 2008 (“EESA”). The provisions of EESA amended by the ARRA include (i) expanding the coverage of the executive compensation limits to as many as the 25 most highly compensated employees of a TARP funds recipient and its affiliates for certain aspects of executive compensation limits and (ii) specifically limiting incentive compensation of covered executives to one-third of their annual compensation which is required to be paid in restricted stock that does not vest until all of the TARP funds are no longer outstanding (note that if TARP warrants remain outstanding and no other TARP instruments are outstanding, then such warrants would not be considered outstanding for purposes of this incentive compensation restriction. In addition, the board of directors of any TARP recipient is required under EESA, as amended to have a company-wide policy regarding excessive or luxury expenditures, as identified by the Treasury, which may include excessive expenditures on entertainment or events; office and facility renovations; aviation or other transportation services; or other activities or events that are not reasonable expenditures for staff development, reasonable performance incentives, or other similar measures conducted in the normal course of the business operations of the TARP recipient.

EESA, as amended by ARRA, provides for a new incentive compensation restriction for financial institutions receiving TARP funds. The number of executives and employees covered by this new incentive compensation restriction depends on the amount of TARP funds received by such entity. For community banks that have or will receive less than $25 million, the new incentive compensation restriction applies only to the highest paid employee. This new incentive compensation restriction prohibits a TARP recipient from paying or accruing any bonus, retention award, or incentive compensation during the period in which any TARP obligation remains outstanding, except that such prohibition shall not apply to the payment of long-term restricted stock by such TARP recipient, provided that such long-term restricted stock (i) does not fully vest during the period in which any TARP obligation remains outstanding, (ii) has a value in an amount that is not greater than 1/3 of the total amount of annual compensation of the employee receiving the stock; and (iii) is subject to such other terms and conditions as the Secretary of the Treasury may determine is in the public interest. In addition, this prohibition does not prohibit any bonus payment required to be paid pursuant to a written employment contract executed on or before February 11, 2009, as such valid employment contracts are determined by the Treasury.

EESA was amended by ARRA to also provide additional corporate governance provisions with respect to executive compensation including the following:

- ESTABLISHMENT OF STANDARDS - During the period in which any TARP obligation remains outstanding, each TARP recipient shall be subject to the standards in the regulations issued by the Treasury with respect to executive compensation limitations for TARP recipients, and the provisions of section 162(m)(5) of the Internal Revenue Code of 1986, as applicable (nondeductibility of executive compensation in excess of $500,000).

- COMPLIANCE WITH STANDARDS - The Treasury is required to see that each TARP recipient meet the required standards for executive compensation and corporate governance.

- SPECIFIC REQUIREMENTS FOR THE REQUIRED STANDARDS -

- Limits on compensation that exclude incentives for senior executive officers of the TARP recipient to take unnecessary and excessive risks that threaten the value of the financial institution during the period in which any TARP obligation remains outstanding.

- A clawback requirement by such TARP recipient of any bonus, retention award, or incentive compensation paid to a senior executive officer and any of the next 20 most highly-compensated employees of the TARP recipient based on statements of earnings, revenues, gains, or other criteria that are later found to be materially inaccurate.

- A prohibition on such TARP recipient making any golden parachute payment to a senior executive officer or any of the next 5 most highly-compensated employees of the TARP recipient during the period in which any TARP obligation remains outstanding.

- A prohibition on any compensation plan that would encourage manipulation of the reported earnings of such TARP recipient to enhance the compensation of any of its employees.

- A requirement for the establishment of an independent Compensation Committee that meets at least twice a year to discuss and evaluate employee compensation plans in light of an assessment of any risk posed to the TARP recipient from such plans. For a non SEC company that is a TARP recipient that has received $25,000,000 or less of TARP assistance, the duties of the compensation committee may be carried out by the board of directors of such TARP recipient.

In addition, EESA as amended by ARRA provides that for any TARP recipient, its annual meeting materials shall include a nonbinding shareholder approval proposal of executive compensation for shareholders to vote. The SEC is to establish regulations to implement this provision. While nonpublic companies are required to include this proposal, it is not known what the regulations will provide as to executive compensation disclosure requirements of such TARP recipients, and whether they will be as extensive as the existing SEC executive compensation requirements. In addition, shareholders are allowed to present other nonbinding proposals with respect to executive compensation.

ARRA also provides $730 million to the SBA and makes changes to the agency's lending and investment programs so that they can reach more small businesses that need help. The funding includes:

- $375 million for temporarily eliminating fees on SBA-backed loans and raising SBA's guarantee percentage on some loans to 90 percent.

- $255 million for a new loan program to help small businesses meet existing debt payments

- $30 million for expanding SBA's Microloan program, enough to finance up to $50 million in new lending and $24 million in technical assistance grants to microlenders.

On February 10, 2009, the U. S. Treasury, the Federal Reserve Board, the FDIC, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision all announced a comprehensive set of measures to restore confidence in the strength of U.S. financial institutions and restart the critical flow of credit to households and businesses. This program is intended to restore the flows of credit necessary to support recovery.

The core program elements include:

- A new Capital Assistance Program to help ensure that our banking institutions have sufficient capital to withstand the challenges ahead, paired with a supervisory process to produce a more consistent and forward-looking assessment of the risks on banks' balance sheets and their potential capital needs.

- A new Public-Private Investment Fund on an initial scale of up to $500 billion, with the potential to expand up to $1 trillion, to catalyze the removal of legacy assets from the balance sheets of financial institutions. This fund will combine public and private capital with government financing to help free up capital to support new lending.

- A new Treasury and Federal Reserve initiative to dramatically expand – up to $1 trillion – the existing Term Asset-Backed Securities Lending Facility (TALF) in order to reduce credit spreads and restart the securitized credit markets that in recent years supported a substantial portion of lending to households, students, small businesses, and others.

- An extension of the FDIC's Temporary Liquidity Guarantee Program to October 31, 2009. A new framework of governance and oversight to help ensure that banks receiving funds are held responsible for appropriate use of those funds through stronger conditions on lending, dividends and executive compensation along with enhanced reporting to the public.

In October 2008, the President signed the Emergency Economic Stabilization Act of 2008 (“EESA”), in response to the global financial crisis of 2008 authorizing the United States Secretary of the Treasury with authority to spend up to $700 billion to purchase distressed assets, especially mortgage-backed securities, under the Troubled Assets Relief Program (“TARP”) and make capital injections into banks under the Capital Purchase Program. EESA gives the government the unprecedented authority to buy troubled assets on balance sheets of financial institutions under the Troubled Assets Relief Program and increases the limit on insured deposits from $100,000 to $250,000 through December 31, 2009. Some of the other provisions of EESA are as follows:

- accelerated from 2011 to 2008 the date that the Federal Reserve Bank could pay interest on deposits of banks held with the Federal Reserve to meet reserve requirements;

- to the extent that the U. S. Treasury purchases mortgage securities as part of TARP, the Treasury shall implement a plan to minimize foreclosures including using guarantees and credit enhancements to support reasonable loan modifications, and to the extent loans are owned by the government to consent to the reasonable modification of such loans;

- limits executive compensation for executives for TARP participating financial institutions including a maximum corporate tax deduction limit of $500,000 for each of the top five highest paid executives of such institution, requiring clawbacks of incentive compensation that were paid based on inaccurate or false information, limiting golden parachutes for involuntary and certain voluntary terminations to 2.99x their average annual salary and bonus for the last five years, and prohibiting the payment of incentive compensation that encourages management to take unnecessary and excessive risks with respect to the institution;

- extends the mortgage debt forgiveness provision of the Mortgage Forgiveness Debt Relief Act of 2007 by three years (2012) to ease the income tax burden on those involved with certain foreclosures; and

- qualified financial institutions may count losses on FNMA and FHLMC preferred stock against ordinary income, rather than capital gain income.

On February 10, 2009, the Treasury Secretary announced a new comprehensive financial stability legislation (the "Financial Stability Plan"), which earmarked the second $350 billion of unused funds originally authorized under the EESA. The major elements of the Financial Stability Plan included: (i) a capital assistance program that has invested in convertible preferred stock of certain qualifying institutions, (ii) a consumer and business lending initiative to fund new consumer loans, small business loans and commercial mortgage asset-backed securities issuances, (iii) a public/private investment fund intended to leverage public and private capital with public financing to purchase up to $500 billion to $1 trillion of legacy "toxic assets" from financial institutions, and (iv) assistance for homeowners by providing up to $75 billion to reduce mortgage payments and interest rates and establishing loan modification guidelines for government and private programs.

On October 22, 2009, the Federal Reserve Board issued a comprehensive proposal on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The proposal, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. The proposal also contemplates a detailed review by the Federal Reserve Board of the incentive compensation policies and practices of a number of "large, complex banking organizations." Any deficiencies in compensation practices that are identified may be incorporated into the organization's supervisory ratings, which can affect its ability to make acquisitions or perform other actions. In addition, the proposal provides that enforcement actions may be taken against a banking organization if its incentive compensation arrangements or related risk-management control or governance processes pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies. Similarly, on January 12, 2010, the FDIC announced that it would seek public comment through advance notice of rule making on whether banks with compensation plans that encourage risky behavior should be charged at higher deposit assessment rates than such banks would otherwise be charged.

On September 3, 2009, the U.S. Treasury issued a policy statement entitled “Principles for Reforming the U.S. and International Regulatory Capital Framework for Banking Firms.” The statement was developed in consultation with the U.S. bank regulatory agencies and sets forth eight “core principles” intended to shape a new international capital accord. Six of the core principles relate directly to bank capital requirements. The statement contemplates changes to the existing regulatory capital regime that would involve substantial revisions to, if not replacement of, major parts of the Basel I and Basel II and affect all regulated banking organizations and other systemically important institutions. The statement calls for higher and stronger capital requirements for bank and non-bank financial firms that are deemed to pose a risk to financial stability due to their combination of size, leverage, interconnectedness and liquidity risk. The statement suggested that changes to the regulatory capital framework be phased in over a period of several years with a recommended schedule providing for a comprehensive international agreement by December 31, 2010, with the implementation of reforms by December 31, 2012, although it does remain possible that U.S. bank regulatory agencies could officially adopt, or informally implement, new capital standards at an earlier date. Following the issuance of the statement, on December 17, 2009, the Basel committee issued a set of proposals (the “Capital Proposals”) that would significantly revise the definitions of Tier 1 capital and Tier 2 capital, with the most significant changes being to Tier 1 capital. Most notably, the Capital Proposals would disqualify certain structured capital instruments, such as trust preferred securities, from Tier 1 capital status. The Capital Proposals would also re-emphasize that common equity is the predominant component of Tier 1 capital by adding a minimum common equity to risk-weighted assets ratio and requiring that goodwill, general intangibles and certain other items that currently must be deducted from Tier 1 capital instead be deducted from common equity as a component of Tier 1 capital. The Capital Proposals also leave open the possibility that the Basel committee will recommend changes to the minimum Tier 1 capital and total capital ratios of 4.0% and 8.0%, respectively. Concurrently with the release of the Capital Proposals, the Basel committee also released a set of proposals related to liquidity risk exposure (the “Liquidity Proposals”). The Liquidity Proposals have three key elements, including the implementation of (i) a “liquidity coverage ratio” designed to ensure that a bank maintains an adequate level of unencumbered, high-quality assets sufficient to meet the bank’s liquidity needs over a 30-day time horizon under an acute liquidity stress scenario, (ii) a “net stable funding ratio” designed to promote more medium and long-term funding of the assets and activities of banks over a one-year time horizon, and (iii) a set of monitoring tools that the Basel committee indicates should be considered as the minimum types of information that banks should report to supervisors and that supervisors should use in monitoring the liquidity risk profiles of supervised entities.

In June 2009, the Administration proposed a wide range of regulatory reforms that, if enacted, may have significant effects on the financial services industry in the United States. Significant aspects of the Administration’s proposals included, among other things, proposals (i) that any financial firm whose combination of size, leverage and interconnectedness could pose a threat to financial stability be subject to certain enhanced regulatory requirements, (ii) that federal bank regulators require loan originators or sponsors to retain part of the credit risk of securitized exposures, (iii) that there be increased regulation of broker-dealers and investment advisers, (iv) for the creation of a federal consumer financial protection agency that would, among other things, be charged with applying consistent regulations to similar products (such as imposing certain notice and consent requirements on consumer overdraft lines of credit), (v) that there be comprehensive regulation of OTC derivatives, (vi) that the controls on the ability of banking institutions to engage in transactions with affiliates be tightened, and (vii) that financial holding companies be required to be “well-capitalized” and “well-managed” on a consolidated basis. The Congress, state lawmaking bodies and federal and state regulatory agencies continue to consider a number of wide-ranging and comprehensive proposals for altering the structure, regulation and competitive relationships of the nation’s financial institutions, including rules and regulations related to the broad range of reform proposals set forth by the Obama administration described above. Along with amendments to the Administration’s proposal there are separate comprehensive financial reform bills intended to address in part or whole or vary in part or in whole from the proposals set forth by the Administration were introduced in both houses of Congress in the second half of 2009 and in 2010 and remain under review by both the U.S. House of Representatives and the U.S. Senate.

14

The Temporary Liquidity Guarantee Program was implemented by the FDIC on October 14, 2008 to mitigate the lack of liquidity in the financial markets. The Temporary Liquidity Guarantee Program has two primary components: the Debt Guarantee Program, by which the FDIC will guarantee the payment of certain newly-issued senior unsecured debt, and the Transaction Account Guarantee Program, by which the FDIC will guarantee certain noninterest-bearing and low interest-bearing transaction accounts. The Debt Guarantee Program provides for an FDIC guarantee as to the payment of all senior unsecured debt (with a term of more than 30 days) issued by a qualified participating entity (insured depository institutions, bank and financial holding companies, and certain savings and loan holding companies) up to a limit of 125 percent of all senior unsecured debt outstanding on September 30, 2008, and maturing by June 30, 2009. The FDIC guarantee is until June 30, 2012, and the fee for such guarantee depends on the term with a maximum of 100 basis points for terms in excess of 365 days. The Transaction Account Guarantee Program is the second part of the FDIC's Temporary Liquidity Guarantee Program. The FDIC provides for a temporary full guarantee held at a participating FDIC-insured depository institution of noninterest-bearing and low interest-bearing transaction accounts above the existing deposit insurance limit at the additional cost of 10 basis points per annum. This coverage became effective on October 14, 2008, and would continue through December 31, 2009.

On July 30, 2008, the Housing and Economic Recovery Act was signed the President. It authorizes the Federal Housing Administration to guarantee up to $300 billion in new 30-year fixed rate mortgages for subprime borrowers if lenders write-down principal loan balances to 90 percent of current appraisal value. It is also intended to restore confidence in Fannie Mae and Freddie Mac by strengthening regulations and injecting capital into them. States will be authorized to refinance subprime loans using mortgage revenue bonds. It also establishes the Federal Housing Finance Agency out of the Federal Housing Finance Board and Office of Federal Housing Enterprise Oversight.

In 2008, the Federal Reserve Board, the FDIC, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision amended their regulatory capital rules to permit banks, bank holding companies, and savings associations (as to any of these a "financial institution") to reduce the amount of goodwill that a banking organization must deduct from Tier 1 capital by the amount of any deferred tax liability associated with that goodwill. However, a financial institution that reduces the amount of goodwill deducted from Tier 1 capital by the amount of the deferred tax liability is not permitted to net this deferred tax liability against deferred tax assets when determining regulatory capital limitations on deferred tax assets. For these financial institutions, the amount of goodwill deducted from Tier 1 capital will reflect each institution's maximum exposure to loss in the event that the entire amount of goodwill is impaired or derecognized, an event which triggers the concurrent derecognition of the related deferred tax liability for financial reporting purposes.

On October 7, 2008 the FDIC adopted a restoration plan that would increase the rates banks pay for deposit insurance, and proposed rules for adjusting the system that determines what deposit insurance premium rate a bank pays the FDIC. Currently, banks pay anywhere from five basis points to 43 basis points for deposit insurance. Under the proposal rule, the assessment rate schedule would be raised uniformly by 7 basis points (annualized) beginning on January 1, 2009. Beginning with the second quarter of 2009, changes would be made to the deposit insurance assessment system to make the increase in assessments fairer by requiring riskier institutions to pay a larger share. Together, the proposed changes would improve the way the system differentiates risk among insured institutions and help ensure that the reserve ratio returns to at least 1.15 percent by the end of 2013. The proposed changes to the assessment system include assessing higher rates to institutions with a significant reliance on secured liabilities, which generally raises the FDIC's loss in the event of failure without providing additional assessment revenue. The proposal also would assess higher rates for institutions with a significant reliance on brokered deposits but, for well-managed and well-capitalized institutions, only when accompanied by rapid asset growth. Brokered deposits combined with rapid asset growth have played a role in a number of costly failures, including some recent ones. The proposal also would provide incentives in the form of a reduction in assessment rates for institutions to hold long-term unsecured debt and, for smaller institutions, high levels of Tier 1 capital. The FDIC also voted to maintain the Designated Reserve Ratio at 1.25 percent as a signal of its long term target for the fund.

The Federal Reserve Board in October 2008 approved final amendments to Regulation C that revise the rules for reporting price information on higher-priced mortgage loans. The changes are intended to improve the accuracy and usefulness of data reported under the Home Mortgage Disclosure Act. Regulation C currently requires lenders to collect and report the spread between the annual percentage rate (APR) on a mortgage loan and the yield on a Treasury security of comparable maturity if the spread is greater than 3.0 percentage points for a first lien loan or greater than 5.0 percentage points for a subordinate lien loan. This difference is known as a rate spread. Under the final rule, a lender will report the spread between the loan's APR and a survey-based estimate of APRs currently offered on prime mortgages of a comparable type ("average prime offer rate") if the spread is equal to or greater than 1.5 percentage points for a first lien loan or equal to or greater than 3.5 percentage points for a subordinate-lien loan. The Board will publish average prime offer rates based on the Primary Mortgage Market Survey® currently published by Freddie Mac. In setting the rate spread reporting threshold, the Board sought to cover subprime mortgages and generally avoid covering prime mortgages. The changes to Regulation C conform the threshold for rate spread reporting to the definition of higher-priced mortgage loans adopted by the Board under Regulation Z (Truth in Lending) in July of 2008.

The Federal Reserve Board in July 2008 approved a final rule for home mortgage loans to better protect consumers and facilitate responsible lending. The rule prohibits unfair, abusive or deceptive home mortgage lending practices and restricts certain other mortgage practices. The final rule also establishes advertising standards and requires certain mortgage disclosures to be given to consumers earlier in the transaction. The final rule, which amends Regulation Z (Truth in Lending) and was adopted under the Home Ownership and Equity Protection Act (HOEPA), largely follows a proposal released by the Board in December 2007, with enhancements that address ensuing public comments, consumer testing, and further analysis.

The final rule adds four key protections for a newly defined category of "higher-priced mortgage loans" secured by a consumer's principal dwelling. For loans in this category, these protections will:

- Prohibit a lender from making a loan without regard to borrowers' ability to repay the loan from income and assets other than the home's value. A lender complies, in part, by assessing repayment ability based on the highest scheduled payment in the first seven years of the loan. To show that a lender violated this prohibition, a borrower does not need to demonstrate that it is part of a "pattern or practice."

- Require creditors to verify the income and assets they rely upon to determine repayment ability.

- Ban any prepayment penalty if the payment can change in the initial four years. For other higher-priced loans, a prepayment penalty period cannot last for more than two years.

- Require creditors to establish escrow accounts for property taxes and homeowner's insurance for all first-lien mortgage loans.

In addition to the rules governing higher-priced loans, the rules adopt the following protections for loans secured by a consumer's principal dwelling, regardless of whether the loan is higher-priced:

- Creditors and mortgage brokers are prohibited from coercing a real estate appraiser to misstate a home's value.

- Companies that service mortgage loans are prohibited from engaging in certain practices, such as pyramiding late fees. In addition, servicers are required to credit consumers' loan payments as of the date of receipt and provide a payoff statement within a reasonable time of request.

- Creditors must provide a good faith estimate of the loan costs, including a schedule of payments, within three days after a consumer applies for any mortgage loan secured by a consumer's principal dwelling, such as a home improvement loan or a loan to refinance an existing loan. Currently, early cost estimates are only required for home-purchase loans. Consumers cannot be charged any fee until after they receive the early disclosures, except a reasonable fee for obtaining the consumer's credit history.

For all mortgages, the rule also sets additional advertising standards. Advertising rules now require additional information about rates, monthly payments, and other loan features. The final rule bans seven deceptive or misleading advertising practices, including representing that a rate or payment is "fixed" when it can change. The rule's definition of "higher-priced mortgage loans" will capture virtually all loans in the subprime market, but generally exclude loans in the prime market. To provide an index, the Federal Reserve Board will publish the "average prime offer rate," based on a survey currently published by Freddie Mac. A loan is higher-priced if it is a first-lien mortgage and has an annual percentage rate that is 1.5 percentage points or more above this index, or 3.5 percentage points if it is a subordinate-lien mortgage. The new rules take effect on October 1, 2009. The single exception is the escrow *requirement, which will be phased in during 2010 to allow lenders to establish new systems as needed.

In California, the enactment of AB329 in 2009, the Reverse Mortgage Elder Protection Act of 2009 prohibits a lender or any other person who participates in the origination of the mortgage from participation in, being associated with, or employing any party that participates in or is associated with any other financial or insurance activity or referring a prospective borrower to anyone for the purchase of other financial or insurance products; and imposes certain disclosure requirements on the lender.

The enactment of AB1160 in 2009, requires a supervised financial institution in California that negotiates primarily in any of a number of specified languages in the course of entering into a contract or agreement for a loan or extension of credit secured by residential real property, to deliver, prior to the execution of the contract or agreement, and no later than 3 business days after receiving the written application, a specified form in that language summarizing the terms of the contract or agreement; provides for administrative penalties for violations; and requires the California Department of Corporations and the Department of Financial Institutions to create a form for providing translations and make it available in Spanish, Chinese, Tagalog, Vietnamese and Korean. The statute becomes operative on July 1, 2010, or 90 days after issuance of the form, whichever occurs later.

The enactment of AB 1291 in 2009 makes changes to the California Unclaimed Property Law including (among other things): allowing electronic notification to customers who have consented to electronic notice; requiring that notices contain certain information and allow the holder to provide electronic means to enable the owner to contact the holder in lieu of returning the prescribed form to declare the owner’s intent; authorizing the holder to give additional notices; and requiring, beginning January 1, 2011, a banking or financial organization to provide a written notice regarding escheat at the time a new account or safe deposit box is opened.

The enactment of SB306 makes specified changes to clarify existing law related to filing a notice of default on residential real property in California, including (among other things): clarifying that the provisions apply to mortgages and deeds of trust recorded from January 1, 2003 through December 31, 2007, secured by owner-occupied 3 4 residential real property containing no more than 4 dwelling units; revising the declaration to be filed with the notice of default; specifying how the loan servicers have to maximize net present value under their pooling and servicing agreements applies to certain investors; specifying how and when the notice to residents of property subject to foreclosure is to be mailed; and extending the time during which the notice of sale must be recorded from 14 to 20 days. The bill also makes certain changes related to short-pay agreements and short-pay demand statements.

On February 20, 2009, Governor Schwarzenegger signed ABX2 7 and SBX2 7, which established the California Foreclosure Prevention Act. The California Foreclosure Prevention Act modifies the foreclosure process to provide additional time for borrowers to work out loan modifications while providing an exemption for mortgage loan servicers that have implemented a comprehensive loan modification program. Civil Code Section 2923.52 requires an additional 90 day period beyond the period already provided before a Notice of Sale can be given in order to allow all parties to pursue a loan modification to prevent foreclosure of loans meeting certain criteria identified in that section.

A mortgage loan servicer who has implemented a comprehensive loan modification program may file an application for exemption from the provisions of Civil Code Section 2923.52. Approval of this application provides the mortgage loan servicer an exemption from the additional 90-day period before filing the Notice of Sale when foreclosing on real property covered by the new law.

California Assembly Bill 1301 was signed by the Governor on July 16, 2008 and became law on January 1, 2009. Among other things, the bill eliminated unnecessary applications that consume time and resources of bank licensees and which in many cases are now perfunctory. All of current Article 5 – “Locations of Head Office” of Chapter 3, and all of Chapter 4 – “Branch Offices, Other Places of Business and Automated Teller Machines” were repealed. A new Chapter 4 – “Bank Offices” was added. The new Chapter 4 requires notice to the California Department of Financial Institutions (“DFI”) the establishment of offices, rather than the current application process. Many of the current branch applications are perfunctory in nature and/or provide for a waiver of application. Banks, on an exception basis, may be subject to more stringent requirements as deemed necessary. As an example, new banks, banks undergoing a change in ownership and banks in less than satisfactory condition may be required to obtain prior approval from the DFI before establishing offices if such activity is deemed to create an issue of safety and soundness. The bill eliminated unnecessary provisions in the Banking Law that are either outdated or have become undue restrictions to bank licensees. Chapter 6 – “Powers and Miscellaneous Provisions” was repealed. A new Chapter 6 - “Restrictions and Prohibited Practices” was added. This chapter brings together restrictions in bank activities as formerly found in Chapter 18 – “Prohibited Practices and Penalties.” However, in bringing the restrictions into the new chapter, various provisions were updated to remove the need for prior approval by the DFI Commissioner. The bill renumbered current Banking Law sections to align like sections. Chapter 4.5 – “Authorizations for Banks” was added. The purpose of the chapter is to provide exceptions to certain activities that would otherwise be prohibited by other laws outside of the Financial Code. The bill added Article 1.5 - “Loan and Investment Limitations” to Chapter 10 – “Commercial Banks.” This article is new in concept and acknowledges that investment decisions are business decisions – so long as there is a diversification of the investments to spread any risk. The risk is diversified in this article by placing a limitation on the loans and investments that can be made to any one entity. This section is a trade-off for elimination of applications to the DFI for approval of investments in securities, which were repealed.

Other changes AB 1301 made to the Banking Law:

- Authorized a bank or trust acting in any capacity under a court or private trust to arrange for the deposit of securities in a securities depository or federal reserve bank, and provided how they may be held by the securities depository;

- Reduced from 5% to 1% the amount of eligible assets to be maintained at an approved depository by an office of a foreign (other nation) bank for the protection of the interests of creditors of the bank's business in this state or for the protection of the public interest;

- Enabled the DFI to issue an order against a bank licensee parent or subsidiary;

- Provided that the examinations may be conducted in alternate examination periods if the DFI concludes that an examination of the state bank by the appropriate federal regulator carries out the purpose of this section, but the DFI may not accept two consecutive examination reports made by federal regulators;

- Provided that the DFI may examine subsidiaries of every California state bank, state trust company, and foreign (other nation) bank to the extent and whenever and as often as the DFI shall deem advisable;

- Enabled the DFI issue an order or a final order to now include any bank holding company or subsidiary of the bank, trust company, or foreign banking corporation that is violating or failing to comply with any applicable law, or is conducting activities in an unsafe or injurious manner;

• Enabled the DFI to take action against a person who has engaged in or participated in any unsafe or unsound act with regard to a bank, including a former employee who has left the bank.

It is impossible to predict what effect the enactment of certain of the above-mentioned legislation will have on the Company. Moreover, it is likely that other bills affecting the business of banks may be introduced in the future by the United States Congress or California legislature.

Employees

At December 31, 2009, the Company employed 141 persons on a full-time equivalent basis. The Company believes its employee relations are excellent.

Available Information

The Company files period reports and other reports under the Securities and Exchange Act of 1934 with the Securities and Exchange Commission (SEC). These reports, as well as the Company's Code of Ethics, are posted and are available at no cost on the Company's website at http://www.unitedsecuritybank.com as soon as reasonably practical after the Company files such reports with the SEC. The Company's periodic and other reports filed with the SEC are also available at the SEC's website (http://www.sec.gov).

Item 1A. Risk Factors

There are risk factors that may affect the Company's business and impact the results of operations, some of which are beyond the control of the Company.

Difficult market conditions and economic trends have adversely affected the banking industry and could continue to adversely affect the Company's business, financial condition, results of operations and cash flows.

The Company is operating in a challenging and uncertain economic environment, including generally uncertain conditions nationally and locally in its markets. Financial institutions continue to be affected by declines in the real estate market that have negatively impacted the credit performance of construction, commercial real estate loans, and residential mortgage loans and resulted in significant write-downs of assets by many financial institutions. Concerns over the stability of the financial markets and the economy have resulted in decreased lending by financial institutions to their customers and to each other. The Company retains direct exposure to the residential and commercial real estate markets, and it is affected by these events. Continued declines in real estate values, home sales volumes and financial stress on borrowers as a result of the uncertain economic environment, including job losses, could have an adverse affect on the Company's borrowers or their customers, which could adversely affect the Company's business, financial condition, results of operations and cash flows.

The Company's ability to assess the creditworthiness of customers and to estimate the losses inherent in its credit portfolio is made more complex by these difficult market and economic conditions. The Company also expects to face increased regulation and government oversight as a result of these downward trends. This increased government action may increase the Company's costs and limit its ability to pursue certain business opportunities. In addition, the Company may be required to pay even higher FDIC deposit insurance premiums than the recently increased level, because financial institution failures resulting from the depressed market conditions and other factors have depleted and may continue to deplete the deposit insurance fund and reduce its ratio of reserves to insured deposits.

A prolonged national economic recession or further deterioration of these conditions in the Company's markets could drive losses beyond that which is provided for in its allowance for credit losses and result in the following consequences:

- increases in loan delinquencies;
- increases in nonperforming assets and foreclosures;
- decreases in demand for the Company’s products and services, which could adversely affect its liquidity position; and
- decreases in the value of the collateral securing the Company’s loans, especially real estate, which could reduce customers’ borrowing power.

A worsening of these conditions would likely exacerbate the adverse effects of these difficult economic conditions on the Company, its customers and the other financial institutions in its market. As a result, the Company may experience increases in foreclosures, delinquencies and customer bankruptcies, as well as more restricted access to funds.

The U.S. Treasury and the FDIC have initiated programs to address economic stabilization, yet the efficacy of these programs in stabilizing the economy and the banking system at large are uncertain.

The Bank is subject to certain operating restrictions.

As the result of a recent written agreement with the Federal Reserve Bank (see Regulatory Action included in Supervision and Regulation section of Item 1) , the Bank's results of operations and financial condition will be impacted by its ability to address certain conditions or achieve certain financial ratios, including strengthening board oversight of management and the Bank's operations; enhancing credit risk management practices and improving the Bank's position on the past due loans, classified loans, and other real estate owned; maintaining a sound process for determining, documenting, and recording an adequate allowance for loan and lease losses; improving the management of the Bank's liquidity position and funds management policies; maintaining sufficient capital at the Company and Bank level; and improving the Bank's earnings and overall condition. Although management of the Bank expects to fully address each of these matters, no assurances can be given that the actions of management will be successful. The failure to address these operating concerns could negatively impact results of operations and the Bank's financial condition and lead to additional regulatory action.

Current levels of market volatility are unprecedented and could adversely impact the Company's results of operations and access to capital.

The capital and credit markets have been experiencing volatility and disruption for more than a year. In recent months, the volatility and disruption has reached unprecedented levels. In some cases, the markets have produced downward pressure on stock prices and credit capacity for certain issuers without regard to those issuers' underlying financial strength. If the current levels of market disruption and volatility continue or worsen, there can be no assurance that the Company will not experience further adverse effects, which may be material, on its ability to access capital and on its business, financial condition and results of operations.

Liquidity risk could impair the Company's ability to fund operations and jeopardize its financial condition.

Liquidity is essential to the Company's business. An inability to raise funds through deposits, borrowings, the sale of loans and other sources could have a substantial negative effect on its liquidity. The Company's access to funding sources in amounts adequate to finance its activities or on terms which are acceptable to it could be impaired by factors that affect the Company specifically or the financial services industry or economy in general. Factors that could detrimentally impact the Company's access to liquidity sources include a decrease in the level of its business activity as a result of a downturn in the markets in which its loans are concentrated or adverse regulatory action against it. The Company's ability to borrow could also be impaired by factors that are not specific to it, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry in light of the recent turmoil faced by banking organizations and the continued deterioration in credit markets.

The Company's financial performance is subject to interest rate risk.

The Company's operations are greatly influenced by general economic conditions and by related monetary and fiscal policies of the federal government. Deposit flows and the funding costs are influenced by interest rates of competing investments and general market rates of interest. Lending activities are affected by the demand for loans, which in turn is affected by the interest rates at which such financing may be offered and by other factors affecting the availability of funds.

The Company's performance is substantially dependent on net interest income, which is the difference between the interest income received from interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities. To reduce the Company's exposure to interest rate fluctuations, management seeks to manage the balances of interest sensitive assets and liabilities, and maintain appropriate maturity and repricing parameters for these assets and liabilities. A mismatch between the amount of rate sensitive assets and rate sensitive liabilities in any time period may expose the Company to interest rate risk. Generally, if rate sensitive assets exceed rate sensitive liabilities, the net interest margin will be positively impacted during a rising rate environment and negatively impacted during a declining rate environment. When rate sensitive liabilities exceed rate sensitive assets, the net interest margin will generally be positively impacted during a declining rate environment and negatively impacted during a rising rate environment.

Increases in the level of interest rates may reduce the overall level of loans originated by the Company, and, thus, the amount of loan and commitment fees earned, as well as the market value of investment securities and other interest-earning assets. Moreover, fluctuations in interest rates may also result in disintermediation, which is the flow of funds away from depository institutions into direct investments, such as corporate securities and other investment vehicles which, because of the absence of federal deposit insurance, generally pay higher rates of return than depository institutions.

The continued deterioration of local economic conditions in the Company's market area could hurt profitability.

The Company's operations are located primarily in Fresno, Madera, Kern, and Santa Clara Counties, and are concentrated in Fresno County and surrounding areas. As a result of this geographic concentration, the Company's financial results depend largely upon economic conditions in these areas. The local economy in the Company's market areas rely heavily on agriculture, real estate, professional and business services, manufacturing, trade and tourism. The significant economic downturn experienced in the sub-prime lending and credit markets since the later part of 2007, has negatively impacted the Company's operations and financial condition, and may further worsen with further deterioration of local and state-wide economic conditions. Poor economic conditions could cause the Company to incur additional losses associated with higher default rates and decreased collateral values in the loan portfolio.

Concentrations in commercial and industrial loans, real estate-secured commercial loans, and real estate construction loans, may expose the Company to increased lending risks, especially in the event of a recession.

The Company has significant concentrations in commercial real estate and real estate construction loans. As of December 31, 2009, 23.0%, and 20.7% of the Company's loan portfolio was concentrated in these two categories, respectively. In addition, the Company has many commercial loans to businesses in the construction and real estate industry. There has been significant volatility in real estate values in the Company's market area in recent years, and an extended real estate recession affecting these market areas would likely reduce the security for many of the Company's loans and adversely affect the ability of many of borrowers to repay loan balances due the Company and require increased provisions to the allowance for loan losses. Therefore, the Company's financial condition and results of operations may continue to be adversely affected by a decline in the value of the real estate securing the Company's loans.

If the Company forecloses on collateral property, we may be subject to the increased costs associated with the ownership of real property, resulting in reduced revenues.

The Company has and may continue to foreclose on collateral property to protect its investment and may thereafter own and operate such property, in which case we will be exposed to the risks inherent in the ownership of real estate. The amount that the Company, as a mortgagee, may realize after a default is dependent upon factors outside of the Company's control, including, but not limited to: (i) general or local economic conditions; (ii) neighborhood values; (iii) interest rates; (iv) real estate tax rates; (v) operating expenses of the mortgaged properties; (vi) environmental remediation liabilities; (vii) ability to obtain and maintain adequate occupancy of the properties; (viii) zoning laws; (ix) governmental rules, regulations and fiscal policies; and (x) acts of God. Certain expenditures associated with the ownership of real estate, principally real estate taxes, insurance, and maintenance costs, may adversely affect the income from the real estate, and as a result, the Company may be required to dispose of the real property at a loss. The foregoing expenditures and costs could adversely affect the Company's ability to generate revenues, resulting in reduced levels of profitability.

The small to medium-sized businesses that the Company lends to may have fewer resources to weather a downturn in the economy, which may impair a borrower's ability to repay a loan to the Company that could materially harm the Company's operating results.

The Company targets its business development and marketing strategy primarily to serve the banking and financial services needs of small to medium-sized businesses. These small to medium-sized businesses frequently have smaller market share than their competition, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete and may experience significant volatility in operating results. Any one or more of these factors may impair the borrower's ability to repay a loan. In addition, the success of a small to medium-sized business often depends on the management talents and efforts of one or two persons or a small group of persons, and the death, disability or resignation of one or more of these persons could have a material adverse impact on the business and its ability to repay a loan. Economic downturns and other events that negatively impact the Company's market areas could cause the Company to incur substantial credit losses that could negatively affect the Company's results of operations, financial condition and cash flows.

The Company faces strong competition, which may adversely affect its operating results.

In recent years, competition for bank customers, the source of deposits and loans for the Company has greatly intensified. This competition includes:

- larger regional and national banks and other FDIC insured depository institutions in many of the communities the Company serves;
- finance companies, investment banking and brokerage firms, and insurance companies that offer bank-like products;
- credit unions, which can offer highly competitive rates on loans and deposits because they receive tax advantages not available to commercial banks; and
- technology-based financial institutions including large national and super-regional banks offering on-line deposit, bill payment, and mortgage loan application services.

Some of the financial services organizations with which the Company competes are not subject to the same degree of regulation as is imposed on bank holding companies and federally insured financial institutions. As a result, these non-bank competitors have certain advantages over the Company in accessing funding and in providing various banking-related services.

By virtue of their larger capital position, regional and national banks have substantially larger lending limits than the Company, and can provide certain services to their customers which the Company is not able to offer directly, such as trust and international services. Many of these larger banks also operate with greater economies of scale which result in lower operating costs than the Company on a per-unit basis.

Other existing single or multi-branch community banks, or new community bank start-ups, have marketing strategies similar to United Security Bancshares. These other community banks can open new branches in the communities the Company serves and compete directly for customers who want the high level of service community banks offer. Other community banks also compete for the same management personnel and the same potential acquisition and merger candidates. Ultimately, competition can drive down the Company's interest margins and reduce profitability, as well as make it more difficult for the Company to achieve its growth objectives.

The Company may need to raise additional capital in the future and such capital may not be available when needed or at all.

The Company may need to raise additional capital in the future to provide it with sufficient capital resources and liquidity to meet its commitments and business needs. In addition, the Company may elect to raise additional capital to support its business or to finance acquisitions, if any. The Company's ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of its control, and its financial performance. The ongoing liquidity crisis and the loss of confidence in financial institutions may increase the Company's cost of funding and limit its access to some of its customary sources of capital, including, but not limited to, inter-bank borrowings, repurchase agreements and borrowings from the discount window of the Federal Reserve.

The Company cannot assure you that such capital will be available to it on acceptable terms or at all. Any occurrence that may limit its access to the capital markets, such as a decline in the confidence of investors, depositors of the Banks or counterparties participating in the capital markets, may adversely affect the Company's capital costs and its ability to raise capital and, in turn, its liquidity. An inability to raise additional capital on acceptable terms when needed could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company could experience loan losses, which exceed the overall allowance for loan losses.

The risk of credit losses on loans and leases varies with, among other things, general economic conditions, the type of loan being made, the creditworthiness of the borrower, and, in the case of collateralized loans, the value and marketability of the collateral. The Company maintains an allowance for loan losses based upon, among other things, historical experience, an evaluation of economic conditions, and regular reviews of delinquencies and loan portfolio quality. Based upon such factors, management makes various assumptions and determinations about the ultimate collectibility of the loan portfolio and provides an allowance for losses based upon a percentage of the outstanding balances and for specific loans where their collectibility is considered to be questionable.

As of December 31, 2009, the Company's allowance for loan losses was approximately $15.0 million representing 2.96% of gross outstanding loans. Although management believes that the allowance is adequate, there can be no absolute assurance that it will be sufficient to cover future loan losses. Although the Company uses the best information available to make determinations with respect to adequacy of the allowance for loan losses, future adjustments may be necessary if economic conditions change substantially from the assumptions used or if negative developments occur with respect to non-performing or performing loans. If management's assumptions or conclusions prove to be incorrect and the allowance for loan losses is not adequate to absorb future losses, or if Company's regulatory agencies require an increase in the allowance for loan losses, the Company's earnings, and potentially its capital, could be significantly and adversely impacted.

The Company is Subject to Other-than-temporary Impairment Risk

The Company recognizes an impairment charge when the decline in the fair value of equity, debt securities and cost-method investments below their cost basis are judged to be other-than-temporary. Significant judgment is used to identify events or circumstances that would likely have a significant adverse effect on the future use of the investment. The Company considers various factors in determining whether an impairment is other-than-temporary, including the severity and duration of the impairment, forecasted recovery, the financial condition and near-term prospects of the investee, and our ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value. Information about unrealized gains and losses is subject to changing conditions. The values of securities with unrealized gains and losses will fluctuate, as will the values of securities that we identify as potentially distressed. Our current evaluation of other-than-temporary impairments reflects our intent to hold securities for a reasonable period of time sufficient for a forecasted recovery of fair value. However, our intent to hold certain of these securities may change in future periods as a result of facts and circumstances impacting a specific security. If our intent to hold a security with an unrealized loss changes, and we do not expect the security to fully recover prior to the expected time of disposition, we will write down the security to its fair value in the period that our intent to hold the security changes.

The process of evaluating the potential impairment of goodwill and other intangibles is highly subjective and requires significant judgment. The Company estimates expected future cash flows of its various businesses and determines the carrying value of these businesses. The Company exercises judgment in assigning and allocating certain assets and liabilities to these businesses. The Company then compares the carrying value, including goodwill and other intangibles, to the discounted future cash flows. If the total of future cash flows is less than the carrying amount of the assets, an impairment loss is recognized based on the excess of the carrying amount over the fair value of the assets. Estimates of the future cash flows associated with the assets are critical to these assessments. Changes in these estimates based on changed economic conditions or business strategies could result in material impairment charges in future periods.

If the goodwill that the Company recorded in connection with a business acquisition becomes impaired, it could require charges to earnings, which would have a negative impact on the Company's financial condition, results of operations and cash flows.

Goodwill represents the amount of acquisition cost over the fair value of net assets the Company acquired in the purchase of another financial institution. The Company reviews goodwill for impairment at least annually, or more frequently if events or changes in circumstances indicate the carrying value of the asset might be impaired.

The Company determines impairment by comparing the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Any such adjustments are reflected in the Company's results of operations in the periods in which they become known. At December 31, 2009, the Company's goodwill totaled $7.4 million after recognizing a goodwill impairment loss of $3.0 million during the year ended December 31, 2009. Given the current economic environment, there can be no assurance that the Company's future evaluations of goodwill will not result in additional findings of impairment and related write-downs, which may have a material adverse effect on its financial condition, results of operations and cash flows.

The loss of any of the Company's executive officers or key personnel could be damaging to the business.

The Company depends upon the skills and reputations of its executive officers and key employees for its future success. The loss of any of these key persons or the inability to attract and retain other key personnel could adversely affect the Company's business operations.

The Company's growth and expansion strategy may not prove to be successful and as a result, its market value and profitability may suffer.

The Company plans to grow operations within its market area and expand into new market areas when it makes strategic business sense, however the Company's capacity to manage any such growth will depend primarily on the ability to attract and retain qualified personnel, monitor operations, maintain earnings and control costs. The Company expects to continue to grow its assets and deposits, the products and services which it offers and accordingly the scale of its operations. The Company's ability to manage growth successfully will depend on the ability to maintain cost controls and asset quality while attracting additional loans and deposits on favorable terms. If the Company grows too quickly and is not able to control costs and maintain asset quality, this rapid growth could materially adversely affect the financial performance of the Company. The future successful growth of the Company will depend on the ability of its officers and other key employees to continue to implement and improve operational, credit, financial, management and other internal risk controls and processes, reporting systems and procedures, and to manage a growing number of customer relationships. The Company may not successfully implement improvements to management information and control systems, and control procedures and processes, in an efficient or timely manner and may discover deficiencies in existing systems and controls. In particular, the Company's controls and procedures must be able to accommodate an increase in expected loan volume and the infrastructure that comes with growth. Thus, the Company's growth strategy may divert management from existing businesses and may require the Company to incur additional expenditures to expand its administrative and operational infrastructure. If the Company is unable to manage future expansion in its operations, it may experience compliance and operational problems, need to slow the pace of growth, or need to incur additional expenditures beyond current projections to support such growth, any one of which could adversely affect the Company's business and profitability.

The regulatory environment under which the Company operates may have an adverse impact on the banking industry.

The Company is subject to extensive regulatory supervision and oversight from both federal and state authorities. Regulatory oversight of the Company is provided by the Federal Reserve Bank (FRB) and the California Department of Financial Institutions (DFI). Future legislation and government may adversely impact the Company and the commercial banking industry in general. Future regulatory changes may also alter the structure and competitive relationship among financial institutions.

The Company may be exposed to compliance risk resulting from violations or nonconformity with laws, rules, regulations, internal policies and procedures, or ethical standards set forth by regulatory authorities. The Company may also be subject to compliance risk in situations where laws or rules governing certain products or activities of the Company's customers may be uncertain or untested. Compliance risk exposes the Company to fines, civil money penalties, payment of damages, and the potential voiding of contracts. Compliance risk can result in diminished reputation, reduced franchise value, limited business opportunities, and reduced growth potential.

Increase in FDIC insurance premiums may negatively affect profitability.

The FDIC insures deposits at FDIC insured financial institutions, including the Bank. The FDIC charges the insured financial institutions premiums to maintain the Deposit Insurance Fund at a certain level. Current economic conditions have increased bank failures and expectations for further failures, in which case the FDIC insures payment of deposits up to insured limits from the Deposit Insurance Fund. In late 2008, the FDIC announced an increase in insurance premium rates of seven basis points, beginning with the first quarter of 2009. Additional changes, beginning April 1, 2009, were to require riskier institutions to pay a larger share of premiums by factoring in rate adjustments based on secured liabilities and unsecured debt levels.

On May 22, 2009, the FDIC adopted a final rule that imposed a special assessment for the second quarter of 2009 of five basis points on each insured depository institution's assets minus its Tier 1 capital as of June 30, 2009, which was collected on September 30, 2009. The Company expensed $334,000 during the second quarter for this special assessment. In November 2009, the FDIC approved a final rule to require all insured depository institutions including the Bank to prepay three years of FDIC assessments in the fourth quarter of 2009, except in the event such prepayment is waived by the FDIC. Although the three-year prepayment assessment was waived for the Bank by the FDIC, insurance premiums paid quarterly have increased substantially during the later part of 2009, and may increase in future periods.

In general, we are unable to control the amount of premiums that we are required to pay for FDIC insurance. If there are additional failures of FDIC-insured institutions, we may be required to pay even higher FDIC premiums. The announced increases and any future increases in FDIC insurance premiums may materially adversely affect our results of operations.

If the Company lost a significant portion of its low-cost core deposits, it would negatively impact profitability.

The Company's profitability depends in part on its success in attracting and retaining a stable base of low-cost deposits. As of December 31, 2009, noninterest-bearing checking accounts comprised 24.9% of the Company's deposit base, and interest-bearing checking and money market accounts comprised an additional 8.6% and 19.7%, respectively. The Company considers these deposits to be core deposits. If the Company lost a significant portion of these low-cost deposits, it would negatively impact its profitability and long-term growth objectives. While Management generally does not believe these deposits are sensitive to interest-rate fluctuations, the competition for these deposits in the Company's market area is strong and if the Company were to lose a significant portion of these low-cost deposits, it would negatively affect business operations.

The Company relies on dividends from its subsidiaries for most of its revenue.

United Security Bancshares is a separate and distinct legal entity from its subsidiaries. The Company receives substantially all of its revenue from dividends from its subsidiary, United Security Bank. These dividends are the principal source of funds to pay dividends on common stock and interest on the Company’s junior subordinated debt. Various federal and/or state laws and regulations limit the amount of dividends that United Security Bank and certain non-bank subsidiaries may pay to United Security Bancshares. Also, United Security Bancshares’ right to participate in a distribution of assets upon a subsidiary’s liquidation or reorganization is subject to the prior claims of the subsidiary’s creditors. As a result of the written agreement with the Federal Reserve Bank entered into March 23, 2010, the United Security Bank is unable to pay dividends to United Security Bancshares, and United Security Bancshares is not able to pay dividends on common stock, or pay interest on its junior subordinated debt. This could have a negative impact on the Company's business, financial condition and results of operations. Under regulatory restraints, the Bank is currently precluded from paying dividends to the Company and may be precluded from doing so into the foreseeable future.

We have elected to defer interest payments on our trust preferred securities which prevents us from paying dividends on our capital stock until those payments are brought current.

We have not paid any cash dividends on our common stock since the second quarter of 2008 and do not expect to resume common stock dividends for the foreseeable future. In order to preserve capital, we elected at September 30, 2009 to defer quarterly payments of interest on our junior subordinated debentures issued in connection with our trust preferred securities beginning with the quarterly payment due October 1, 2009. The terms of the debentures permit us to defer payment of interest for up to 20 consecutive quarters. Interest continues to accrue while interest payments are deferred. Under the terms of the trust preferred securities we are prohibited from paying cash dividends on our capital stock (including common stock) during the deferral period.

The holders of the Company’s junior subordinated debentures have rights that are senior to those of the Company’s shareholders.

On July 25, 2007 the Company issued $15.5 million of floating rate junior subordinated debentures in connection with a $15.0 million trust preferred securities issuance by its subsidiary, United Security Bancshares Capital Trust II. The junior subordinated debentures mature in July 2037.

The Company conditionally guarantees payments of the principal and interest on the trust preferred securities. The Company’s junior subordinated debentures are senior to holders of common stock. As a result, the Company must make payments on the junior subordinated debentures (and the related trust preferred securities) before any dividends can be paid on our common stock and, in the event of bankruptcy, dissolution or liquidation, the holders of the debentures must be satisfied before any distributions can be made to the holders of common stock. The Company has elected to defer distributions on our junior subordinated debentures (and the related trust preferred securities) for up to five years, during which time no dividends may be paid to holders of common stock.

The Company may become subject to environmental liability risk associated with lending activities.

A significant portion of the Company’s loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, the Company may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require the Company to incur substantial expenses and may materially reduce the affected property’s value or limit the ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although the

Company has policies and procedures to perform an environmental review before initiating any foreclosure action on nonresidential real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on the Company's financial condition and results of operations.

The Company's Internal controls and procedures may fail or be circumvented.

Management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based, in part, on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the Company's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect the Company's business, results of operations and financial condition.

The Company’s information systems may experience an interruption or breach in security.

The Company relies heavily on communications and information systems to conduct its business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in customer relationship management, general ledger, deposit, loan and other systems. While the Company has policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of its information systems, there can be no assurance that we can prevent any such failures, interruptions or security breaches or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of the Company’s information systems could damage our reputation, result in a loss of customer business, subject the Company to additional regulatory scrutiny, or expose it to civil litigation and possible financial liability, any of which could have a material adverse effect on the Company’s financial condition and results of operations.

The Company continually encounters technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. The Company’s future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in the Company’s operations. Many of the Company’s competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to the company’s customers and even if such products and services are implemented, the Company may incur substantial costs in doing so. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on the Company’s business, financial condition and results of operations.

Severe weather, natural disasters, acts of war or terrorism and other external events could significantly impact the Company’s business.

Severe weather, natural disasters, including but not limited to earthquakes and droughts, acts of war or terrorism and other adverse external events could have a significant impact on the Company’s ability to conduct business. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause the Company to incur additional expenses. Severe weather or natural disasters, acts of war or terrorism or other adverse external events may occur in the future. Although management has established disaster recovery policies and procedures, there can be no assurance of the effectiveness of such policies and procedures, and the occurrence of any such event could have a material adverse effect on the Company’s business, financial condition and results of operations.

Item 1B. - Unresolved Staff Comments

The Company had no unresolved staff comments at December 31, 2009.

Item 2 - Properties

The Bank’s Main bank branch is located at 2151 West Shaw Avenue, Fresno, California. The Company owns the building and leases the land under a sublease dated December 1, 1986 between Central Bank and USB. The current sublessor under the master ground lease is Bank of the West, which acquired the position through the purchase of Central Bank. The lessor under the ground lease (Master Lease) is Thomas F. Hinds. The lease expires on December

31, 2015 and the Company has options to extend the term for four (4) ten-year periods and one seven (7) year period.

The Company leases the banking premises of approximately 6,450 square feet for its second of three Fresno branches at 7088 N. First Ave, Fresno, California., under a lease which commenced August 2005 for a term of ten years expiring in July 2015. The branch was previously located at 1041 E. Shaw Avenue, Fresno, California, under a lease extension expiring February 28, 2005. The lease was renewed until August 2005. The 7088 N. First location provides space for the relocated branch as well as the Real Estate Construction Department and the Indirect Consumer Lending Department.

The Company leases the Oakhurst bank branch located at the Old Mill Village Shopping Center, 40074 Highway 49, Oakhurst, California. The branch facility consists of approximately 5,000 square feet with a lease term of 15 years ending April 2014, and has two five-year options to extend the lease term after that date.

The Company owns the Caruthers bank branch located at 13356 South Henderson, Caruthers, California, which consists of approximately 5,000 square feet of floor space.

The Company owns the San Joaquin branch facilities located at 21574 Manning Avenue, San Joaquin, California. The bank branch is approximately 2,500 square feet.

The Company owns the Firebaugh bank branch located at 1067 O Street, Firebaugh, California. The premises are comprised of approximately 4,666 square feet of office space situated on land totaling approximately one-third of an acre.

The Company owns the Coalinga bank branch located at 145 East Durian, Coalinga, California. The office building has a total of 6,184 square feet of interior floor space situated on approximately 0.45 acres of land.

The Company leases the Convention Center branch located at 855 “M” Street, Suite 130, Fresno, California. Total space leased is approximately 4,520 square feet, and was occupied during March 2004. The fifteen-year lease expires in March 2019. There are no extension provisions.

The Company owns the Taft branch office premises located at 523 Cascade Place, Taft, California. The branch facilities consist of approximately 9,200 square feet of office space.

The Company owns the branch facilities located at 3404 Coffee Road, Bakersfield, California, which has approximately 6,130 square feet of office space located on 1.15 acres.

The Company leases the Campbell branch located at 125 E. Campbell Ave, Campbell, California, which has approximately 6,995 square feet which it occupied after the merger completed in February 2007. The lease expires on December 31, 2010.

The Company subleases the space for its USB Financial Services offices at 855 “M” Street, Suite 1120, Fresno, California from Centex Homes, Inc. The subleased facility totals 3,656 square feet and the lease expires on March 31, 2010. After March 31, 2010, the USB Financial Services staff will occupy space in the Company’s administrative headquarters located at 2126 Inyo Street, Fresno, California.

The Company owns its administrative headquarters at 2126 Inyo Street, Fresno, California. The facility consists of approximately 21,400 square feet. A portion of the premises has been subleased to a third-party under a lease term of approximately seven years.

Item 3 - Legal Proceedings

From time to time, the Company is party to claims and legal proceedings arising in the ordinary course of business. At this time, the management of the Company is not aware of any material pending litigation proceedings to which it is a party or has recently been party to, which will have a material adverse effect on the financial condition or results of operations of the Company.

Item 4 - Reserved

PART II

Item 5 - Market for the Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

Trading History

The Company became a NASDAQ National Market listed company on May 31, 2001, then became a Global Select listed company during 2006, and trades under the symbol UBFO.

The Company currently has four market makers for its common stock. These include, Stone & Youngberg, LLC, Howe Barnes Hoeffer & Arnett, Sandler O'Neill & Partners, and Hill Thompson, Magid & Company. The Company is aware of two other securities dealers: Smith Barney and Dean Witter Reynolds Inc., which periodically act as brokers in the Company's stock.

On March 28, 2006, the Company announced a 2-for-1 stock split of the Company's no-par common stock payable May 1, 2006 effected in the form of a 100% stock dividend. Share information for all periods presented in this 10-K have been restated to reflect the effect of the stock split.

During the third quarter ended September 30, 2008 and the fourth quarter ended December 31, 2008, the Company declared 1% stock dividends. During each of the quarters ended March 31, 2009, June 30, 2009, September 30, 2009, and December 31, 2009, the Company again declared 1% stock dividends. Share information for all periods presented in this Form 10-K has been restated to reflect the effect of the 1% stock dividends.

The Company was included in the Russell 2000 Stock Index during June 2006 and remained a member of the Russell 2000 Stock Index until June 2009, when the Company's market capitalization fell below the threshold required to remain on the Index. The inclusion of the Company's stock in the index has provided additional exposure for the Company in equity markets, and increased the transaction volume.

The following table sets forth the high and low closing sales prices by quarter for the Company's common stock, for the years ended December 31, 2009 and 2008.

	Closing Prices		
Quarter	High	Low	Volume
4th Quarter 2009	$ 5.60	$ 2.50	975,000
3rd Quarter 2009	$ 6.00	$ 4.10	1,377,400
2nd Quarter 2009	$ 9.57	$ 4.35	2,427,600
1st Quarter 2009	$ 11.81	$ 4.72	979,600
4th Quarter 2008	$ 16.06	$ 6.89	950,400
3rd Quarter 2008	$ 17.90	$ 12.67	1,045,700
2nd Quarter 2008	$ 17.54	$ 13.58	1,309,300
1st Quarter 2008	$ 18.20	$ 12.41	1,689,400

At January 31, 2009, there were approximately 841 record holders of common stock of the Company. This does not reflect the number of persons or entities who hold their stock in nominee or street name through various brokerage firms.

Dividends

The Company's shareholders are entitled to cash dividends when and as declared by the Company’s Board of Directors out of funds legally available therefore. Dividends paid to shareholders by the Company are subject to restrictions set forth in California General Corporation Law, which provides that a corporation may make a distribution to its shareholders if retained earnings immediately prior to the dividend payout are at least equal the amount of the proposed distribution. As a bank holding company without significant assets other than its equity position in the Bank, the Company’s ability to pay dividends to its shareholders depends primarily upon dividends it receives from the Bank. Such dividends paid by the Bank to the Company are subject to certain limitations. See “Management’s Discussion and Analysis of Financial and Results of Operations – Regulatory Matters”.

The Company distributed a 1% stock dividend to shareholders on January 21, 2009, April 22, 2009, July 22, 2009, and then again on October 21, 2009. During the previous year, the Company paid cash dividends to shareholders of $0.13 per share on January 23, 2008, and April 23, 2008. The Company also distributed a 1% stock dividend to shareholders on July 23, 2008, and then again on October 22, 2008.

The amount and payment of dividends by the Company to shareholders are set by the Company's Board of Directors with numerous factors involved including the Company's earnings, financial condition and the need for capital for expanded growth and general economic conditions. No assurance can be given that cash or stock dividends will be paid in the future.

Securities Authorized for Issuance under Equity Compensation Plans

The following table sets forth securities authorized for issuance under equity compensation plans as for December 31, 2009.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (column a)		Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	177,804	$	15.01	323,976
Equity compensation plans not approved by security holders	N/A		N/A	N/A
Total	177,804	$	15.01	323,976

A complete description of the above plans is included in Note 10 of the Company’s Financial Statements in Item 8 of this Annual Report on Form 10K, and is hereby incorporated by reference.

Purchases of Equity Securities by Affiliates and Associated Purchasers

On August 30, 2001 the Company announced that its Board of Directors approved a plan to repurchase, as conditions warrant, up to 280,000 shares (560,000 shares adjusted for May 2006 stock split) of the Company's common stock on the open market or in privately negotiated transactions. The duration of the program was open-ended and the timing of purchases was dependent on market conditions. A total of 215,423 shares (430,846 shares adjusted for May 2006 stock split) had been repurchased under that plan as of December 31, 2003, at a total cost of $3.7 million.

On February 25, 2004 the Company announced a second stock repurchase plan under which the Board of Directors approved a plan to repurchase, as conditions warrant, up to 276,500 shares (553,000 shares adjusted for May 2006 stock split) of the Company's common stock on the open market or in privately negotiated transactions. As with the first plan, the duration of the new program is open-ended and the timing of purchases will depend on market conditions. Concurrent with the approval of the new repurchase plan, the Board terminated the 2001 repurchase plan and canceled the remaining 64,577 shares (129,154 shares adjusted for May 2006 stock split) yet to be purchased under the earlier plan.

On May 16, 2007, the Company announced another stock repurchase plan to repurchase, as conditions warrant, up to 610,000 shares of the Company's common stock on the open market or in privately negotiated transactions. The repurchase plan represents approximately 5.00% of the Company's currently outstanding common stock. The duration of the program is open-ended and the timing of purchases will depend on market conditions. Concurrent with the approval of the new repurchase plan, the Company canceled the remaining 75,733 shares available under the 2004 repurchase plan.

During the year ended December 31, 2008, 89,001 shares were repurchased at a total cost of $1.21 million and an average per share price of $13.70. During the year ended December 31, 2009, 488 shares were repurchased at a total cost of $3,700 and an average per share price of $7.50.

Financial Performance

The following performance graph does not constitute soliciting material and should not be deemed filed incorporated by reference into any other Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent the Company specifically incorporates the performance graph by reference therein.

	Period Ending					
Index	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08	12/31/09
United Security Bancshares	100.00	122.90	198.37	128.15	101.12	39.98
Russell 2000	100.00	104.55	123.76	121.82	80.66	102.58
Russell 3000	100.00	106.12	122.80	129.11	80.94	103.88
SNL Bank $500M-$1B Index	100.00	104.29	118.61	95.04	60.90	58.00

Item 6 - Selected Financial Data

The following table sets forth certain selected financial data for the Bank for each of the years in the five-year periods ended December 31, 2009 and should be read in conjunction with the more detailed information and financial statements contained elsewhere herein (in thousands except per share data and ratios).

	December 31,				
(in thousands except per share data and ratios)	2009	2008	2007	2006	2005
Summary of Year-to-Date Earnings:					
Interest income and loan fees	$ 35,673	$ 45,147	$ 57,156	$ 47,356	$ 38,898
Interest expense	7,327	14,938	20,573	14,175	9,658
Net interest income	28,346	30,209	36,583	33,181	29,240
Provision for credit losses	13,375	9,526	6,231	880	1,140
Net interest income after Provision for credit losses	14,971	20,683	30,372	32,301	28,100
Noninterest income	6,308	8,343	9,681	9,031	6,280
Noninterest expense	27,966	23,351	22,215	19,937	16,982
(Loss) income before taxes on income	(6,688)	5,675	17,818	21,395	17,398
Taxes on income	(2,150)	1,605	6,561	8,035	6,390
Net (loss) income	$ (4,537)	$ 4,070	$ 11,257	$ 13,360	$ 11,008
Per Share Data:					
Net (loss) income – Basic	$ (0.36)	$ 0.32	$ 0.89	$ 1.11	$ 0.91
Net (loss) income – Diluted	$ (0.36)	$ 0.32	$ 0.89	$ 1.10	$ 0.91
Average shares outstanding – Basic	12,496,578	12,537,955	12,659,442	12,042,293	12,069,323
Average shares outstanding - Diluted	12,496,578	12,541,516	12,696,327	12,167,476	12,157,751
Cash dividends paid	$ 0.00	$ 0.26	$ 0.50	$ 0.43	$ 0.35
Financial Position at Period-end:					
Total assets	$ 692,567	$ 761,077	$ 771,715	$ 678,314	$ 628,859
Total net loans and leases	492,692	531,788	583,625	489,764	407,416
Total deposits	561,660	508,486	634,617	587,127	546,460
Total shareholders' equity	75,821	79,610	82,431	66,042	59,014
Book value per share	$ 6.07	$ 6.37	$ 6.55	$ 5.51	$ 4.89
Selected Financial Ratios:					
Return on average assets	(0.62%)	0.52%	1.47%	2.04%	1.76%
Return on average shareholders' equity	(5.77%)	4.93%	13.73%	20.99%	19.46%
Average shareholders' equity to average assets	10.71%	10.60%	10.73%	9.70%	9.02%
Allowance for credit losses as a percentage of total nonperforming loans	43.20%	25.24%	45.99%	57.50%	91.31%
Net charge-offs to average loans	1.85%	0.93%	0.77%	0.05%	0.15%
Allowance for credit losses as a percentage of period-end loans	2.96%	2.12%	1.26%	0.88%	1.04%

Dividend payout ratio	0.00%	80.12%	56.39%	39.16%	38.65%

30

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Certain matters discussed or incorporated by reference in this Annual Report on Form 10-K are forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Such risks and uncertainties include, but are not limited to, those described in Management’s Discussion and Analysis of Financial Condition and Results of Operations. Such risks and uncertainties include, but are not limited to, the following factors: i) competitive pressures in the banking industry and changes in the regulatory environment; ii) exposure to changes in the interest rate environment and the resulting impact on the Company’s interest rate sensitive assets and liabilities; iii) decline in the health of the economy nationally or regionally which could reduce the demand for loans or reduce the value of real estate collateral securing most of the Company’s loans; iv) credit quality deterioration that could cause an increase in the provision for loan losses; v) Asset/Liability matching risks and liquidity risks; volatility and devaluation in the securities markets, and vi) expected cost savings from recent acquisitions are not realized. Therefore, the information set forth therein should be carefully considered when evaluating the business prospects of the Company.

The Company

On June 12, 2001, the United Security Bank (the “Bank”) became the wholly owned subsidiary of United Security Bancshares (the “Company”) through a tax-free holding company reorganization, accounted for on a basis similar to the pooling of interest method. In the transaction, each share of Bank stock was exchanged for a share of Company stock on a one-to-one basis. No additional equity was issued as part of this transaction. In the following discussion, references to the Bank are references to United Security Bank. References to the Company are references to United Security Bancshares (including the Bank).

On June 28, 2001, United Security Bancshares Capital Trust I (the “Trust”) was formed as a Delaware business trust for the sole purpose of issuing Trust Preferred securities. On July 16, 2001, the Trust completed the issuance of $15 million in Trust Preferred securities, and concurrently, the Trust used the proceeds from that offering to purchase Junior Subordinated Debentures of the Company. The Company contributed $13.7 million of the $14.5 million in net proceeds received from the Trust to the Bank to increase its regulatory capital and used the rest for the Company’s business. Effective January 1, 2007, the Company adopted the fair value option for its junior subordinated debt issued by the Trust. As a result of the adoption of the accounting standards related to the fair value option, the Company recorded a fair value adjustment of $1.3 million, reflected as an adjustment to beginning retained earnings. On July 25, 2007, the Company redeemed the $15.0 million in subordinated debentures plus accrued interest of $690,000 and a 6.15% prepayment penalty totaling $922,500. Concurrently, the Trust Preferred securities issued by Capital Trust I were redeemed. The prepayment penalty of $922,500 had previously been a component of the fair value adjustment for the junior subordinated debt at the initial adoption of the fair value option.

Effective December 31, 2001, United Security Bank formed a subsidiary Real Estate Investment Trust (“REIT”) through which preferred stock was offered to private investors, to raise capital for the bank in accordance with the laws and regulations in effect at the time. The principal business purpose of the REIT was to provide an efficient and economical means to raise capital. The REIT also provided state tax benefits beginning in 2002. On December 31, 2003 the California Franchise Tax Board (FTB) announced certain tax transactions related to real estate investment trusts (REITs) and regulated investment companies (RICs) will be disallowed pursuant to Senate Bill 614 and Assembly Bill 1601, which were signed into law in the 4th quarter of 2003 (For further discussion see Income Taxes section of Results of Operations contained in this Management’s Discussion and Analysis of Financial Condition and Results of Operations).

Effective April 23, 2004, the Company completed its merger with Taft National Bank headquartered in Taft, California. Taft National Bank ("Taft") was merged into United Security Bank and Taft's two branches began operating as branches of United Security Bank. The total consideration paid to Taft shareholders was 241,447 shares of the Company's common stock valued at just over approximately $6.0 million. As a result of the merger, the Company acquired $15.4 million in cash and short-term investments, $23.3 million in loans, and $48.2 million in deposits.

During August 2005, the Bank formed a new subsidiary named United Security Emerging Capital Fund (the Fund) for the purpose of providing investment capital for Low-Income Communities (LIC's). The new subsidiary was formed as a Community Development Entity (CDE) and as such, must be certified by the Community Development Financial Institutions Fund of the United States Department of the Treasury in order to apply for New Market Tax Credits (NMTC). The Fund submitted an application to the Department of the Treasury to become certified as a CDE in August 2005 and was approved in February 2006. Subsequent to that application, the Fund submitted an application to apply for an allocation of New Market Tax Credits in September 2005. The Fund was not awarded funding from the Department of Treasury during the 2006 allocation process, but applied for the 2007 allocation of New Market Tax Credits in August 2006. The Fund was not awarded funding during the 2007 allocation process. The Fund did not apply for allocations of New Market Credits during 2007, 2008, or 2009. If the Fund's NMTC is ever approved for the allocation of New Market Credits, the Fund can attract investments and make loans and investments in LIC's and thereby qualify its investors to receive Federal Income Tax Credits. The maximum that can be applied for under the New Markets Tax Credit program by any one CDE is $150 million, and the Bank is subject to an investment limitation of 10% of its risk-based capital. Federal new market tax credits would be applied over a seven-year period, 5% for the first three years, and 6% for the next four years for a total of 39%.

On February 16, 2007, the Company completed its merger of Legacy Bank, N.A. with and into United Security Bank, a wholly owned subsidiary of the Company. Legacy Bank which began operations in 2003 operated one banking office in Campbell, California serving small business and retail banking clients. With its small business and retail banking focus, Legacy Bank provides a unique opportunity for United Security Bank to serve a loyal and growing small business niche and individual client base in the San Jose area. Upon completion of the merger, Legacy Bank's branch office began operating as a branch office of United Security Bank. As of February 16, 2007 Legacy Bank had net assets of approximately of $8.6 million, including net loans of approximately $62.4 million and deposits of approximately $69.6 million.

In the merger with Legacy Bank, the Company issued 976,411 shares of its stock in a tax free exchange for all of the Legacy Bank common shares. The total value of the transaction was approximately $21.7 million. The merger transaction was accounted for using the purchase accounting method, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Legacy based on the fair value of those assets and liabilities. Fair-market-value adjustments and intangible assets totaled approximately $12.9 million, including $8.8 million in goodwill. The allocations of purchase price based upon the fair market value of assets acquired and liabilities assumed were finalized during the fourth quarter of 2007.

During July 2007, the Company formed USB Capital Trust II, a wholly-owned special purpose entity, for the purpose of issuing Trust Preferred Securities. Like USB Capital Trust I formed in July 2001, USB Capital Trust II is a Variable Interest Entity (VIE) and a deconsolidated entity pursuant current accounting standards related to variable interest entities. On July 23, 2007 USB Capital Trust II issued $15 million in Trust Preferred securities. The securities have a thirty-year maturity and bear a floating rate of interest (repricing quarterly) of 1.29% over the three-month LIBOR rate. Interest is payable quarterly. Concurrent with the issuance of the Trust Preferred securities, USB Capital Trust II used the proceeds of the Trust Preferred securities offering to purchase a like amount of junior subordinated debentures of the Company. The Company pays interest on the junior subordinated debentures to USB Capital Trust II, which represents the sole source of dividend distributions to the holders of the Trust Preferred securities. The Company elected at September 30, 2009 to defer quarterly payments of interest on the junior subordinated debentures beginning with the quarterly payment due October 1, 2009. The terms of the debentures permit the deferment of payment of interest for up to 20 consecutive quarters. Interest continues to accrue while interest payments are deferred. Under the terms of the trust preferred securities the Company is prohibited from paying dividends on its capital stock (including common stock) during the deferral period. The Company may redeem the junior subordinated debentures at anytime before October 2008 at a redemption price of 103.3, and thereafter each October as follows: 2008 at 102.64, 2009 at 101.98, 2010 at 101.32, 2011 at 100.66, and at par anytime after October 2012.

The Bank currently has eleven banking branches, one construction lending office, and one financial services office, which provide banking and financial services in Fresno, Madera, Kern, and Santa Clara counties. As a community-oriented bank holding company, the Company continues to seek ways to better meet its customers' needs for financial services, and to expand its business opportunities in today's ever-changing financial services environment. The Company's strategy is to be a better low-cost provider of services to its customer base while enlarging its market area and corresponding customer base to further its ability to provide those services.

The Company has made certain reclassifications to the previous year's financial information to conform to the classifications used in 2009. Effective January 1, 2009, the Company reclassified a contingent asset that represents a claim from an insurance company related to a charged-off lease portfolio, including specific reserves, from loans to other assets. Management believes the asset is better reflected, given its nature, as an asset other than loans (see Note 1 to the consolidated financial statements contained in Item 8 of this Form 10-K for more details). All periods presented have been retroactively adjusted for the reclassification to other assets and therefore amounts have been excluded from loans and reserves for credit losses, including impaired and nonaccrual balances for periods prior to December 31, 2009. The contingent asset was ultimately settled during the quarter ended June 30, 2009 resulting in a pretax gain of $117,000. In addition, At December 31, 2009, the Company reclassified certain loans in its portfolio for reporting purposes. In particular, certain loans previously classified as commercial and industrial loans have been retrospectively reclassified as either construction and development loans, or commercial real estate loans, depending on whether they are partially completed, or are generating rental income (see Significant Accounting Policies in Note 1 to the consolidated financial statements contained in Item 8 of this Form 10K for more details.)

Current Trends Affecting Results of Operations and Financial Position

The Company's overall operations are impacted by a number of factors, including not only interest rates and margin spreads, which impact results of operations, but also the composition of the Company's balance sheet. One of the primary strategic goals of the Company is to maintain a mix of assets that will generate a reasonable rate of return without undue risk, and to finance those assets with a low-cost and stable source of funds. Liquidity and capital resources must also be considered in the planning process to mitigate risk and allow for growth.

The following table summarizes the year-to-date averages of the components of interest-bearing assets as a percentage of total interest bearing assets, and the components of interest-bearing liabilities as a percentage of total interest-bearing liabilities:

	YTD Average 12/31/09	YTD Average 12/31/08	YTD Average 12/31/07
Loans	85.09%	84.11%	84.88%
Investment securities	13.38%	14.41%	13.57%
Interest-bearing deposits in other banks	0.94%	1.40%	1.03%
Federal funds sold	0.59%	0.08%	0.52%
Total earning assets	100.00%	100.00%	100.00%
NOW accounts	8.80%	7.92%	8.82%
Money market accounts	22.68%	22.89%	25.99%
Savings accounts	6.86%	7.50%	8.79%
Time deposits	39.94%	42.51%	50.05%
Other borrowings	19.44%	16.84%	3.40%
Trust Preferred Securities	2.28%	2.34%	2.95%
Total interest-bearing liabilities	100.00%	100.00%	100.00%

Continued weakness in the real estate markets and the general economy have impacted the Company's operations during the past year with increased levels of nonperforming assets, increased expenses related to foreclosed properties, and decreased profit margins. Although the Company continues its business development and expansion efforts throughout its market area, increased attention has been placed on reducing nonperforming assets and providing customers more options to help work through this difficult economic period.

With market rates of interest declining 100 basis points during the fourth quarter of 2007, and another 400 basis points during the year ended December 31, 2008, the Company continues to experience compressed net interest margins. The Company's net interest margin was 4.51% for the year ended December 31, 2009, as compared to 4.36% for the year ended December 31, 2008, and 5.40% for the year ended December 31, 2007. With approximately 62% of the loan portfolio in floating rate instruments at December 31, 2009, the effects of low market rates continue to impact loan yields. Loans yielded 5.83% during the year ended December 31, 2009, as compared to 6.81% and 9.16% for the years ended December 31, 2008 and 2007, respectively. With the rapid decline in market rates of interest experienced during 2008, deposit repricing was slow to follow the decline in loan rates during the second half of 2008. However, with stock market declines, combined with more substantial FDIC insurance coverage, deposit rates declined during the fourth quarter of 2008 as investors sought safety in bank deposits. Borrowing rates declined significantly during the fourth quarter of 2008 and have remained low during 2009, resulting in overnight and short-term borrowing rates of less than 0.50% during much of the year. The Company has benefited from these rate declines, as it has continued to utilize overnight and short-term borrowing lines through the Federal Reserve and Federal Home Loan Bank to a greater degree. In addition, brokered and other wholesale deposits provided lower rates than much of the Company's market area during much of the second half of 2009. The Company's average cost of funds was 1.43% for the year ended December 31, 2009 as compared to 2.75% and 3.91% for the years ended December 31, 2008 and 2007.

Total noninterest income of $6.3 million reported for the year ended December 31, 2009 decreased $2.0 million or 24.4% as compared to the year ended December 31, 2008, resulting in declines in all but two of the noninterest income categories between the two annual periods. Noninterest income continues to be driven by customer service fees, which totaled $3.9 million for the year ended December 31, 2009, representing a decrease of $774,000 or 16.6% over the $4.7 million in customer service fees reported for the year ended December 31, 2008, and a decrease of $908,000 or 19.0% over the $4.8 million reported for the year ended December 31, 2007. Other components of noninterest income have become more volatile during the past several years as many have been nonrecurring or non-sustainable, including gains or losses on other real estate owned through foreclosure or other asset disposals as the Company works to reduce problem assets. Although we believe the decline in current economic conditions has had an impact on the level of customer service fees, decreases in ATM fees between the periods presented resulting from the loss of a contract during 2008 to provide multiple ATM’s in a single location have also adversely impacted the level of customer service fees. Customer service fees represented 61.5%, 55.8%, and 49.5% of total noninterest income for the years ended December 31, 2009, 2008, and 2007, respectively.

Noninterest expense increased approximately $4.6 million or 19.8% between the years ended December 31, 2008 and December 31, 2009, and increased $5.8 million of 25.9% between the years ended December 31, 2007 and December 31, 2009. Although noninterest expense increased only minimally between 2007 and 2008, significant increases experienced during the year ended December 31, 2009 were primarily the result of both increases in impairment charges, as well as increased costs associated with problem loan workouts, as well as OREO maintenance and disposal preparation costs on foreclosed properties. A major component of the increase in noninterest expense experienced during the year ended December 31, 2009 was a goodwill impairment loss totaling $3.0 million recognized during the second quarter of 2009. While impairment losses on the Company's core deposit intangible assets decreased $567,000 between the years ended December 31, 2008 and 2009, the Company took impairment charges of $1.3 million during 2009 on real estate owned through foreclosure, and $843,000 on investment securities. Salary expense decreased $2.1 million or 19.4% between the years ended December 31, 2008 and December 31, 2009, primarily as the result of declines in accrued bonuses and employee incentives between the two periods.

Effective September 30, 2009 and beginning with the quarterly interest payment due October 1, 2009, the Company elected to defer interest payments on the Company's $15.0 million of junior subordinated debentures relating to its trust preferred securities. This is the result of regulatory restraints which have precluded the Bank from paying dividends to the Company. The terms of the debentures and trust indentures allow for the Company to defer interest payments for up to 20 consecutive quarters without default or penalty. During the period that the interest deferrals are elected, the Company will continue to record interest expense associated with the debentures. Upon the expiration of the deferral period, all accrued and unpaid interest will be due and payable. Under the terms of the debenture, the Company is precluded from paying cash dividends to shareholders or repurchasing its stock during the deferral period.

The Company has not paid any cash dividends on its common stock since the second quarter of 2008 and does not expect to resume common stock dividends for the foreseeable future. Because the Company has elected to defer the quarterly payments of interest on its junior subordinated debentures issued in connection with the trust preferred securities as discussed above, the Company is prohibited from paying cash dividends on its common stock during the deferral period. As with the first three quarters of 2009, on December 15, 2009 the Company's Board of Directors again declared a one-percent (1%) stock dividend on the Company's outstanding common stock. The stock dividend replaces quarterly cash dividends and reflects a similar value. Although the Company's capital position remains strong, the change in the dividend from cash to stock begun during the third quarter of 2008 was employed as a precaution against uncertainties in the 1-4 family residential real estate market and the potential impact on the Company's construction and related land and lot loan portfolio. The Company believes, given the current uncertainties in the economy and unprecedented declines in real estate valuations in our markets, it is prudent to retain capital in this environment, and better position the Company for future growth opportunities. Based upon the number of outstanding common shares on the record date of January 8, 2010, an additional 123,716 shares were issued to shareholders on January 20, 2010. For purposes of earnings per share calculations, the Company's weighted average shares outstanding and potentially dilutive shares used in the computation of earnings per share have been restated after giving retroactive effect to the 1% stock dividend to shareholders for all periods presented.

The Company has sought to maintain a strong, yet conservative balance sheet while reducing the level of nonperforming assets during the year ended December 31, 2009. Total assets decreased approximately $68.5 million during the year ended December 31, 2009, with a decrease of $39.1 million in interest-bearing deposits in other banks and investment securities as the Company decreased its borrowing exposure during 2009. Decreases of $115.0 million in overnight and term borrowings were partially offset by increases in brokered and other deposits. Declines of approximately $36.0 million in loans during the year ended December 31, 2009 are due in large part to loan charge-offs or transfers to other real estate owned through foreclosure. Average loans comprised approximately 85% of overall average earning assets during the year ended December 31, 2009, a percentage that has remained consistent over the past three years.

Nonperforming assets, which are primarily related to the real estate loan and property portfolio, remained high during the year ended December 31, 2009 as real estate markets continue to suffer from the mortgage crisis which began during mid-2007. Nonaccrual loans totaling $34.8 million at December 31, 2009, decreased $10.5 million from the balance reported at December 31, 2008, and decreased $20.4 million from the balance reported at September 30, 2009. In determining the adequacy of the underlying collateral related to these loans, management monitors trends within specific geographical areas, loan-to-value ratios, appraisals, and other credit issues related to the specific loans. Impaired loans increased $4.8 million during the year ended December 31, 2009 to a balance of $53.8 million at December 31, 2009, but decreased $20.0 million during the quarter ended December 31, 2009. Other real estate owned through foreclosure increased $6.1 million between December 31, 2008 and December 31, 2009, as transfers of $21.7 million in loans to other real estate owned during the year more than offset write-downs and sales of those assets during the year. As a result of these events, nonperforming assets as a percentage of total assets increased from 9.96% at December 31, 2008 to 12.56% at December 31, 2009.

As the economy has declined along with asset valuations, increased emphasis has been placed on impairment analysis of both tangible and intangible assets on the balance sheet. As of March 31, 2009, the Company conducted annual impairment testing on the largest component of its outstanding balance of goodwill, that of the Campbell operating unit (resulting from the Legacy merger during February 2007.) In part, as a result of the severe decline in interest rates and other economic factors within the industry, we could not conclude at March 31, 2009 that there was not a possibility of goodwill impairment under the current economic conditions. During the second quarter of 2009, the Company utilized an independent valuation service to determine the aggregate fair value of the individual assets, liabilities, and identifiable intangible assets of the Campbell operating unit in question to determine if the goodwill related to that operating unit was impaired, and if so, how much the impairment was. Management, with the assistance of the independent third-party, concluded that there was impairment of the goodwill related to the Campbell operating unit, and as a result the Company recognized an impairment loss of $3.0 million or $0.25 per share (pre-tax and after-tax) for the quarter ended June 30, 2009 and the year ended December 31, 2009.

Management continues to monitor economic conditions in the real estate market for signs of further deterioration or improvement which may impact the level of the allowance for credit losses required to cover identified losses in the loan portfolio. Greater focus has been placed on identifying and reducing the level of problem assets, while working with borrowers to find more options, including loan restructures, to work through these difficult economic times. Increased charge-offs and significant provisions for loan losses made during 2009 materially impacted earnings, but the provisions made to the allowance for credit losses, totaling $1.4 million during the first quarter of 2009, $6.8 million during the second quarter of 2009, $435,000 made during the third quarter of 2009, and $4.8 million made during the fourth quarter of 2009, provided a level in the allowance for credit losses that is deemed adequate to cover inherent losses in the loan portfolio. Loan and lease charge-offs totaling $10.1 million during the year ended December 31, 2009 included $2.6 million during the quarter ended March 31, 2009, $1.5 million during the quarter ended June 30, 2009, $1.9 million during the quarter ended September 30, 2009, and an additional $4.2 million during the fourth quarter of 2009.

Deposits increased by $53.2 million during the year ended December 31, 2009, with increases experienced in both interest-bearing checking accounts and time deposits. Increases in time deposits experienced during the later part of 2009 were the result of a plan to reduce the Company's reliance on borrowed funds.

Although balances have declined during the last half of 2009, the Company continues to utilize overnight borrowings and other term credit lines, with borrowings totaling $40.0 million at December 31, 2009, as compared to $54.4 million at September 30, 2009, $135.3 million at June 30, 2009, and $155.0 million at December 31, 2008. The average rate of those term borrowings was 0.86% at December 31, 2009, as compared to 0.95% at September 30, 2009, 0.60% at June 30, 2009, and 0.93% at December 31, 2008. Although the Company continues to realize significant interest expense reductions by utilizing these overnight and term borrowings lines, the use of such lines are monitored closely to ensure sound balance sheet management in light of the current economic, credit, and regulatory environment.

The cost of the Company's subordinated debentures issued by USB Capital Trust II has remained low as market rates have actually declined during most of 2009. With pricing at 3-month-LIBOR plus 129 basis points, the effective cost of the subordinated debt was 1.54% at December 31, 2009, representing a rate reduction of 122 basis points between December 31, 2008 and December 31, 2009. Pursuant to fair value accounting guidance, the Company has recorded $1.2 million in pretax fair value gains on its junior subordinated debt during the year ended December 31, 2009, bringing the total cumulative gain recorded on the debt to $4.9 million at December 31, 2009.

The Company continues to emphasize relationship banking and core deposit growth, and has focused greater attention on its market area of Fresno, Madera, and Kern Counties, as well as Campbell, in Santa Clara County. The San Joaquin Valley and other California markets continue to exhibit weak demand for construction lending and commercial lending from small and medium size businesses, as commercial and residential real estate markets declined during much of 2008, a condition which still persists at this time. The past year has presented significant challenges for the banking industry with tightening credit markets, weakening real estate markets, and increased loan losses adversely affecting the industry.

The Company continually evaluates its strategic business plan as economic and market factors change in its market area. Balance sheet management, enhancing revenue sources, and maintaining market share will be of primary importance during 2010 and beyond. The banking industry is currently experiencing continued pressure on net margins as well as asset quality resulting from conditions in the real estate market, and a general deterioration in credit markets. On March 23, 2010, the Company and the Bank entered into a regulatory agreement with the Federal Reserve Bank which, among other things, requires improvements in the overall condition of the Company and the Bank (see Regulatory Agreement in the Regulatory Matters section of this Management's Discussion and Analysis of Financial Condition and Results of Operations for more details.) As a result, market rates of interest, asset quality, as well as regulatory oversight will continue be an important factor in the Company's ongoing strategic planning process.

Application of Critical Accounting Policies and Estimates

The Company's consolidated financial statements are prepared in accordance with generally accepted accounting principles and follow general practices within the industry in which it operates. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available. When third-party information is not available, valuation adjustments are estimated using the Company's own assumptions about the assumptions that market participants would use in pricing the asset or liability.

The most significant accounting policies followed by the Company are presented in Note 1 to the Company's consolidated financial statements included herein. These policies, along with the disclosures presented in the other financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the determination of the allowance for credit losses, other real estate owned through foreclosure, impairment of collateralized mortgage obligations and other investment securities, and fair value estimates on junior subordinated debt, valuation for deferred income taxes, and goodwill, to be accounting areas that require the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available.

Allowance for Credit Losses

The allowance for credit losses represents management's estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for credit losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the consolidated balance sheet. Note 1 to the consolidated financial statements describes the methodology used to determine the allowance for credit losses and a discussion of the factors driving changes in the amount of the allowance for credit losses is included in the Asset Quality and

Allowance for Credit Losses section of this financial review.

If the loan portfolio were to increase by 10% proportionally throughout all loan classifications, the additional estimated provision to the allowance that would be required, based on the percentage loss allocations utilized at December 31, 2009, would be approximately $1.5 million pretax ($870,000 net of tax, or $0.07 per share basic and diluted). This estimate is comprised of an additional $1.1 million ($611,000 net of tax, or $0.05 per share basic and diluted) for criticized loans (those classified as special mention or worse, excluding those considered impaired and subject to asset-specific reserve allocations under current accounting guidelines), and an additional $448,000 ($260,000 net of tax, or $0.02 per share basic and diluted) for the remainder of the loan portfolio that is performing.

Other Real Estate Owned

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value of the property, less estimated costs to sell. The excess, if any, of the loan amount over the fair value of the collateral is charged to the allowance for credit losses. The determination of fair value is generally based upon pre-approved, external appraisals. As real estate markets declined during over the past two years and essentially became illiquid in many areas, Management was required to use additional judgment in determining the factors associated with fair value of the real estate, including the term over which the properties could be disposed in an orderly liquidation. This became necessary as many appraisals were based upon comparable sales which were deeply discounted forced liquidations or bulk sales caused by the severity of the housing crises. Subsequent declines in the fair value of other real estate owned, along with related revenue and expenses from operations, are charged to noninterest expense. The fair market valuation of such properties is based upon estimates, and as such, is subject to change as circumstances in the Company’s market area, or general economic trends, change.

Impairment of Investment Securities

Investment securities classified as available for sale ("AFS") are carried at fair value and the impact of changes in fair value are recorded on the Company's consolidated balance sheet as an unrealized gain or loss in "Accumulated other comprehensive income (loss)," a separate component of shareholders' equity. Securities classified as AFS or held to maturity ("HTM") are subject to review to identify when a decline in value is other than temporary. In April 2009, the FASB updated the accounting standards for the recognition and presentation of other-than-temporary impairments. The standard amends existing guidance on other-than-temporary impairments for debt securities and requires that the credit portion of other-than-temporary impairments be recorded in earnings and the noncredit portion of losses be recorded in other comprehensive income (loss) when the entity does not intend to sell the security and it is more likely than not that the entity will not be required to sell the security prior to recovery of its cost basis. The Company adopted the standard during the first quarter of 2009. Factors considered in determining whether a decline in value is other than temporary include: whether the decline is substantial; the duration of the decline; the reasons for the decline in value; whether the decline is related to a credit event or to a change in interest rate; our ability and intent to hold the investment for a period of time that will allow for a recovery of value; and the financial condition and near-term prospects of the issuer.

At December 31, 2009, the Company considered three of its investment securities other than temporarily impaired. The three private-label collateralized mortgage obligations (residential mortgage obligations) have an amortized cost of $15.1 million and carrying value of $9.7 million. Impairment analysis on these three residential mortgage obligations was performed utilizing the services of a third-party investment broker specializing in private-label CMO's, and was based upon estimated cash flows. Estimated cash flows were based upon assumptions of future prepayments and default rates, and thus may be subject to revision as events change in the future. For the year ended December 31, 2009, the Company recognized pre-tax losses totaling $842,000 related to the credit portion of the other-than-temporary impairment in earnings. The remaining $4.6 million impairment on the three residential mortgage obligations is recorded as a component of other comprehensive income at December 31, 2009.

Fair Value

Effective January 1, 2007, the Company adopted fair value option accounting standards choosing to apply the standards to its junior subordinated debt. The Company concurrently adopted the accounting standards related to fair value measurements. The accounting standards related to fair value measurements defines how applicable assets and liabilities are to be valued, and requires expanded disclosures about financial instruments carried at fair value. The fair value measurement accounting standard establishes a hierarchical disclosure framework associated with the level of pricing observability utilized in measuring financial instruments at fair value. The degree of judgment utilized in measuring the fair value of financial instruments generally correlates to the level of pricing observability. Financial instruments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of pricing observability and a lesser degree of judgment utilized in measuring fair value. Conversely, financial instruments infrequently traded or not quoted in an active market will generally have little or no pricing observability and a higher degree of judgment utilized in measuring fair value. Pricing observability is impacted by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established and the characteristics specific to the transaction. Determining fair values under the accounting standards may include judgments related to measurement factors that may vary from actual transactions executed in the marketplace. For the years ended December 31, 2009 and December 31, 2008, the Company recorded fair value gains related to its junior subordinated debt totaling $1.1 million and $1.4 million, respectively. (See Notes 8 and 13 of the Notes to Consolidated Financial Statements for additional information about financial instruments carried at fair value.)

Goodwill

Business combinations involving the Company’s acquisition of the equity interests or net assets of another enterprise or the assumption of net liabilities in an acquisition of branches constituting a business may give rise to goodwill. The acquisition of Taft National Bank during April 2004 gave rise to goodwill totaling approximately $1.6 million, and the acquisition of Legacy Bank during February 2007 resulted in goodwill of approximately $8.8 million. Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed in transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Company’s ability to generate net earnings after the acquisition. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed for impairment at a reporting unit level at least annually using an internal cash flow model. During the quarter ended June 30, 2009, the Company recognized goodwill impairment of $3.0 million on the goodwill associated with the 2007 Legacy acquisition. While the Company believes all assumptions utilized in its assessment of goodwill for impairment are reasonable and appropriate, changes in earnings, the effective tax rate, historical earnings multiples and the cost of capital could all cause different results for the calculation of the present value of future cash flows.

Income Taxes

Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. Deferred taxes are measured using current tax rates applied to such taxable income in the years in which those temporary differences are expected to be recovered. If the Company’s future income is not sufficient to apply the deferred tax assets within the tax years to which they may be applied, the deferred tax asset may not be realized and the Company’s income will be reduced.

On January 1, 2007 the Company adopted the accounting standards related to uncertainty in income taxes. The standard prescribes a 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. Under the accounting standards, an entity should recognize the financial statement benefit of a tax position if it determines that it is more likely than not that the position will be sustained on examination. The term “more likely than not” means a likelihood of more than 50 percent.” In assessing whether the more-likely-than-not criterion is met, the entity should assume that the tax position will be reviewed by the applicable taxing authority.

The Company reviewed its various tax positions, including its ongoing REIT case with the California Franchise Tax Board (FTB), as of January 1, 2007 (adoption date), and then again each subsequent quarter during 2007 in light of the adoption of the accounting standards related to uncertainty in income taxes. The Bank, with guidance from advisors believes the case related to consent dividends taken by the Bank’s REIT during 2002 has merit with regard to points of law, and that the tax law at the time allowed for the deduction of the consent dividend. However, the Bank, with the concurrence of advisors, cannot conclude that it is “more than likely” (as defined) that the Bank will prevail in its case with the FTB. As a result of this determination, effective January 1, 2007 the Company recorded an adjustment of $1,298,470 to beginning retained earnings upon adoption of the accounting standards related to uncertainty in income taxes to recognize the potential tax liability under the guidelines of the interpretation. The adjustment includes amounts for assessed taxes, penalties, and interest. During the years ended December 31, 2009, 2008 and 2007, the Company increased the unrecognized tax liability by an additional $87,092, $87,421 and $87,091, respectively, in interest for the period, bringing the total recorded tax liability to $1,560,084, $1,472,992 and $1,385,561 at December 31, 2009, December 31, 2008 and December 31, 2007, respectively. It is the Company’s policy to recognize interest and penalties under FIN48 as a component of income tax expense.

Pursuant to the accounting standards related to uncertainty in income taxes, the Company will continue to re-evaluate existing tax positions, as well as new positions as they arise. If the Company determines in the future that its tax positions are not “more likely than not” to be sustained (as defined) by taxing authorities, the Company may need to recognize additional tax liabilities.

Revenue recognition

The Company’s primary sources of revenue are interest income from loans and investment securities. Interest income is generally recorded on an accrual basis, unless the collection of such income is not reasonably assured or cannot be reasonably estimated. Pursuant to accounting standards related to revenue recognition, nonrefundable fees and costs associated with originating or acquiring loans are recognized as a yield adjustment to the related loans by amortizing them into income over the term of the loan using a method which approximates the interest method. Other credit-related fees, such as standby letter of credit fees, loan placement fees and annual credit card fees are recognized as noninterest income during the period the related service is performed.

For loans placed on nonaccrual status, the accrued and unpaid interest receivable may be reversed at management's discretion based upon management's assessment of collectibility, and interest is thereafter credited to principal to the extent necessary to eliminate doubt as to the collectibility of the net carrying amount of the loan.

Results of Operations

For the year ended December 31, 2009, the Company reported a net loss of $4.5 million or $0.36 per share ($0.36 diluted) as compared to net income of $4.1 million or $0.32 per share ($0.32 diluted) for the year ended December 31, 2008, and net income of $11.3 million or $0.89 per share ($0.89 diluted) for the year ended December 31, 2007. Net income decreased $8.6 million between December 31, 2008 and December 31, 2009 as the result of increased provisions for credit losses taken during the year, combined with declines in the volume of, and yields on earning assets, as well as increases in other impairment losses and OREO-related expenses. Net income decreased $7.2 million between December 31, 2007 and December 31, 2008 as the result of increased provisions for credit losses taken during the third and fourth quarters, combined with significant declines in market rates of interest during 2008.

The Company's return on average assets was (0.62%) for the year ended December 31, 2009 as compared to 0.52 % and 1.47 % for the same twelve-month periods of 2008 and 2007, respectively. The Company's return on average equity was (5.77%) for the year ended December 31, 2009 as compared to 4.93 % and 13.73 % for the same twelve-month periods of 2008 and 2007, respectively. As with declines in net income, declines in the return on average assets and average equity experienced by the Company during 2009 were primarily the result of additional loan loss provisions taken during the year, as well as increased impairment losses and OREO-related expenses.

Net Interest Income

Net interest income, the most significant component of earnings, is the difference between the interest and fees received on earning assets and the interest paid on interest-bearing liabilities. Earning assets consist primarily of loans, and to a lesser extent, investments in securities issued by federal, state and local authorities, and corporations, as well as interest-bearing deposits and overnight funds with other financial institutions. These earning assets are funded by a combination of interest-bearing and noninterest-bearing liabilities, primarily customer deposits and short-term and long-term borrowings.

Net interest income before provision for credit losses totaled $28.3 million for the year ended December 31, 2009 as compared to $30.2 million for the year ended December 31, 2008, and $36.6 million for the year ended December 31, 2007. This represents a decrease of $1.9 million or 6.2 % between the years ended December 31, 2008 and 2009, as compared to a decrease of $6.4 million or 17.4% between 2006 and 2007. The decrease in net interest income between 2008 and 2009, as well as between 2007 and 2008, is primarily the result of decreased yields on interest-earning assets, which more than offset the decreased yields on interest-bearing liabilities.

Table 1. – Distribution of Average Assets, Liabilities and Shareholders' Equity:

Interest rates and interest differentials
Years Ended December 31, 2009, 2008, and 2007

(Dollars in thousands)	2009 Average Balance	Interest	Yield/ Rate	2008 Average Balance	Interest	Yield/ Rate	2007 Average Balance	Interest	Yield/ Rate
Assets:									
Interest-earning assets:									
Loans (1)	$ 534,830	$ 31,197	5.83%	$ 582,500	$ 39,669	6.81%	$ 575,448	$ 52,690	9.16%
Investment Securities – taxable	82,865	4,298	5.19%	98,330	5,170	5.26%	89,765	3,896	4.34%
Investment Securities – nontaxable (2)	1,252	58	4.63%	1,452	68	4.68%	2,227	108	4.85%
Interest on deposits in other banks	5,905	117	1.98%	9,680	222	2.29%	7,001	271	3.87%
Federal funds sold and reverse repos	3,708	3	0.08%	549	18	3.28%	3,527	191	5.42%
Total interest-earning assets	628,560	$ 35,673	5.68%	692,511	$ 45,147	6.52%	677,968	$ 57,156	8.43%
Allowance for credit losses	(12,639)			(8,729)			(5,867)		
Noninterest-bearing assets:									
Cash and due from banks	18,528			20,785			25,255		
Premises and equipment, net	13,731			14,981			15,899		
Accrued interest receivable	2,405			2,779			4,061		
Other real estate owned	34,345			9,434			3,187		
Other assets	49,153			46,122			43,831		
Total average assets	$ 734,083			$ 777,883			$ 764,334		
Liabilities and Shareholders' Equity:									
Interest-bearing liabilities:									
NOW accounts	$ 45,189	$ 176	0.39%	$ 42,988	$ 223	0.52%	$ 46,382	$ 292	0.63%
Money market accounts	116,522	2,214	1.90%	124,202	2,963	2.39%	136,720	4,246	3.11%
Savings accounts	35,228	219	0.62%	40,699	482	1.18%	46,225	883	1.91%
Time deposits	205,261	3,583	1.75%	230,746	8,420	3.65%	263,196	12,993	4.94%
Other borrowings	99,877	804	0.80%	91,368	2,116	2.32%	17,891	925	5.17%
	11,692	331	2.83%	12,710	734	5.77%	15,537	1,234	7.94%

Trust Preferred securities									
Total interest-bearing liabilities	513,769	$ 7,327	1.43%	542,713	$ 14,938	2.75%	525,951	$ 20,573	3.91%
Noninterest-bearing liabilities:									
Noninterest-bearing checking	134,925			144,772			146,954		
Accrued interest payable	623			1,131			2,207		
Other liabilities	6,147			6,782			7,221		
Total average liabilities	655,464			695,398			682,333		
Total average shareholders' equity	78,619			82,485			82,001		
Total average liabilities and									
Shareholders' equity	$ 734,083			$ 777,883			$ 764,334		
Interest income as a percentage									
of average earning assets			5.68%			6.52%			8.43%
Interest expense as a percentage									
of average earning assets			1.17%			2.16%			3.03%
Net interest margin			4.51%			4.36%			5.40%

(1) Loan amounts include nonaccrual loans, but the related interest income has been included only if collected for the period prior to the loan being placed on a nonaccrual basis. Loan interest income includes loan fees of approximately $1,547,000, $3,074,000, and $3,076,000 for the years ended December 31, 2009, 2008, and 2007, respectively.

(2) Applicable nontaxable securities yields have not been calculated on a tax-equivalent basis because they are not material to the Company's results of operations.

As summarized in Table 2, the increase in net interest income between the two twelve-month periods ended December 31, 2009 and 2008 is comprised of a decrease in total interest income of approximately $9.5 million, which was only partially offset by a decrease in total interest expense of approximately $7.6 million. This change is less severe than the previous year's comparison where an increase in net interest income between the two years ended December 31, 2008 and 2007 was comprised of a decrease in total interest income of approximately $12.0 million, which was only partially offset by a decrease in total interest expense of approximately $5.6 million.

The Bank's year-to-date net interest margin, as shown in Table 1, increased to 4.51% at December 31, 2009 from 4.36% at December 31, 2008, an increase of 15 basis points (100 basis points = 1%) between the two periods, but decreased 89 basis points from the 5.40% net margin realized during the year ended December 31, 2007.

As a result of changes in market rates of interest, the prime rate averaged 3.25% for the year ended December 31, 2009 as compared to 5.09% and 8.05% for the years ended December 31, 2008 and 2007, respectively.

Both the Company's net interest income and net interest margin are affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as "volume change." Both are also affected by changes in yields on interest-earning assets and rates paid on interest-bearing liabilities, referred to as "rate change." The following table sets forth the changes in interest income and interest expense for each major category of interest-earning asset and interest-bearing liability, and the amount of change attributable to volume and rate changes for the years indicated. Changes in interest income and expense, which are not attributable specifically to either rate or volume, are allocated proportionately between the two variances based on the absolute dollar amounts of the change in each.

Table 2. Rate and Volume Analysis

	2009 compared to 2008			2008 compared to 2007		
(In thousands)	Total	Rate	Volume	Total	Rate	Volume
Increase (decrease) in interest income:						
Loans	$ (8,472)	$ (5,395)	$ (3,077)	$ (13,021)	$ (13,659)	$ 638
Investment securities	(882)	(70)	(812)	1 ,234	875	359
Interest-bearing deposits in other banks	(105)	(39)	(66)	(49)	(132)	35
Federal funds sold and securities purchased under agreements to resell	(15)	(32)	17	(173)	(55)	(118)
Total interest income	$ (9,474)	(5,536)	(3,938)	$ (12,009)	(12,972)	963
Increase (decrease) in interest expense:						
Interest-bearing demand accounts	(796)	(695)	(101)	(1,352)	(983)	(369)
Savings accounts	(263)	(205)	(58)	(401)	(305)	(96)
Time deposits	(4,837)	(3,992)	(845)	(4,573)	(3,105)	(1,468)
Other borrowings	(1,312)	(1,493)	181	1,191	(759)	1,950
Trust Preferred securities	(403)	(348)	(55)	(500)	(300)	(200)
Total interest expense	(7,611)	(6,733)	(878)	(5,635)	(5,541)	(184)
Increase (decrease) in net interest income	$ (1,863)	$ 1,197	$ (3,060)	$ (6,374)	$ (7,521)	$ 1,147

Total interest income decreased approximately $9.5 million or 21.0% between the years ended December 31, 2008 and 2009, and was attributable to a decrease in yields on those earning assets, and to a lesser degree, earning asset volume. Earning asset decline was mostly in loans, with smaller declines in investments and interest-bearing deposits in other banks. On average, loans decreased by approximately $47.7 million between 2008 and 2009 as the Company focused more on the work-out of problem assets. The Company continues to maintain a high percentage of loans in its earning asset mix with loans averaging 85.1% of total earning assets for the year ended December 31, 2009, as compared to 84.1% and 84.9% for the years ended December 31, 2008 and 2007, respectively.

Total interest expense decreased approximately $7.6 million between the years ended December 31, 2008 and 2009 as a result of significant decreases in rates paid on interest-bearing liabilities during 2009, combined with decreases in the volumes of those interest-bearing liabilities. Deposit rates continued to decline throughout much of 2009 as the Federal Reserve lengthened the anticipated duration of the low-interest rate cycle in its efforts to resolve the severe economic downturn. Between the years ended December 31, 2009 and December 31, 2008, rates paid on interest-bearing liabilities decreased in all categories, and on average decreased to almost half of what they had been during the year ended December 31, 2008. During 2009, the Company benefited as it utilized lower-cost funding sources including overnight and short-term borrowings, as well as brokered and other wholesale time deposits, which provided funding rates of less then 0.50% during a significant portion of the year.

Total interest income decreased approximately $12.0 million or 21.0% between the years ended December 31, 2007 and 2008, and is attributable primarily to significant declines in market rates of interest resulting in decreased net interest margins, which outweighed minor increases experienced in average earning assets. Loans were most adversely impacted by yield declines as approximately two-thirds of the loan portfolio is comprised of floating rate instruments.

Total interest expense decreased approximately $5.6 million between the years ended December 31, 2007 and 2008, primarily as a result of decreased rates paid on deposit accounts and other borrowings as market rates of interest continued to decline throughout most of 2008. Rates paid on interest-bearing liabilities decreased in all categories, with the greatest decreases experienced in time deposits, borrowings through the FHLB and the FRB, and the Company’s junior subordinated debt. The Company’s interest-bearing liability mix changed during 2008 with declines in average deposit accounts, especially time deposits, which was more than offset by increases in the average volume of other borrowings including FHLB advances and overnight borrowings from the Federal Reserve. On average, time deposits decreased $32.5 million, interest-bearing demand accounts decreased by $15.9 million, and savings accounts decreased by $5.5 million between the years ended December 31, 2007 and December 31, 2008. The decrease in average deposits was more than offset by increases of more than $73.5 million in other borrowings between the years ended December 31, 2007 and December 31, 2008.

Provision for Credit Losses

Provisions for credit losses and the amount added to the allowance for credit losses is determined on the basis of management's continuous credit review of the loan portfolio, consideration of past loan loss experience, current and future economic conditions, and other pertinent factors. Such factors consider the allowance for credit losses to be adequate when it covers estimated losses inherent in the loan portfolio. Based on the condition of the loan portfolio, management believes the allowance is sufficient to cover risk elements in the loan portfolio. For the year ended December 31, 2009 the provision to the allowance for credit losses amounted to $13.4 million as compared to $9.5 million and $6.2 million for the years ended December 31, 2008 and 2007, respectively.

During 2009, increases in the provision to the allowance for credit losses included large provisions during the second and fourth quarters of the year as prolonged weakness in the economy, and specifically the residential housing market, required the Company to become even more proactive in its assessment of problem loans. Provisions of $4.8 million and $6.8 million were made in the second and fourth quarters of 2009

Increases in the provision to the allowance for credit losses during 2008, including provisions of $6.4 million and $2.4 million in the third and fourth quarters of 2008, respectively, were the result of higher levels of nonperforming loans during the year, and general deterioration in the housing and credit markets which began during the later part of 2007, and continued throughout 2008.

The amount provided to the allowance for credit losses during 2009 brought the allowance to 2.96% of net outstanding loan balances at December 31, 2009, as compared to 2.12% of net outstanding loan balances at December 31, 2008, and 1.26% at December 31, 2007.

Noninterest Income

The following table summarizes significant components of noninterest income for the years indicated and the net changes between those years:

	Years Ended December 31,			Increase (decrease) during Year	
(In thousands)	2009	2008	2007	2009	2008
Customer service fees	$ 3,882	$ 4,656	$ 4,790	$ (774)	(134)
Gain on disposition of securities	(37)	24	0	(61)	24
Gain (loss) on sale of OREO	(793)	67	209	(860)	(142)
Gain on sale of assets	863	0	0	863	--
Proceeds from life insurance	0	0	483	--	(483)
Gain (loss) on swap ineffectiveness	0	9	66	(9)	(57)
Gain on fair value option of financial liabilities	1,145	1,363	2,504	(218)	(1,141)
Gain (loss) on sale of fixed assets	22	(4)	2	26	(6)
Shared appreciation income	23	265	42	(242)	223
Other	1,203	1,963	1,585	(760)	378
Total	$ 6,308	$ 8,343	$ 9,681	$ (2,035)	$ (1,338)

Noninterest income consists primarily of fees and commissions earned on services that are provided to the Company's banking customers and, to a lesser extent, gains on sales of Company assets and other miscellaneous income. Noninterest income for the year ended December 31, 2009 decreased $2.0 million or 24.4% when compared to the previous year, and decreased $3.4 million or 34.8% when compared to the year ended December 31, 2007. Decreases in noninterest income were experienced in all but two categories during 2009, with decreases experienced in customer service fees, gains in OREO sales, and shared appreciation income. Increases were experienced in gains on sale of assets as the Company disposed of a large inventory of agricultural equipment that had been foreclosed upon during the year. The decrease of $760,000 in other noninterest income experienced during 2009 includes a decrease of approximately $312,000 on OREO rental income; an income decline which the Company does not expect to see change in the future. The loss of $37,000 realized during 2009 on the disposition of investment securities was the result of the sale of a $5.0 million mutual fund that was disposed of for liquidity purposes.

Decreases in noninterest income experienced during 2008 as compared to 2007 were primarily the result of a decrease in fair value gains recorded on the Company's junior subordinated debt, as well as an employee death-benefit payment received during 2007 that did not occur again during 2008. The gain on disposition of securities totaling $24,000 during 2008 was the result of an early call on municipal bonds with an amortized cost of approximately $940,000. The municipal bonds were redeemed at face value, resulting in a recognized gain on the remaining unaccreted discount.

Customer service fees continue to provide a substantial part of noninterest income over the three years presented, representing 61.5%, 55.8%, and 49.4% of total noninterest income for the years ended December 31, 2009, 2008, and 2007, respectively. Customer service fees decreased $774,000 between the years ended December 31, 2008 and December 31, 2009, and decreased $134,000 between the years ended December 2007 and December 31, 2008. Much of the decrease in customer service fees between the periods presented is attributable to decreases in ATM fee income. Additionally, decreases of approximately $450,000 were experienced in revenue generated by the Company's Financial Services department between the years ended December 31, 2008 and December 31, 2009.

The Company has experienced decreases in gains realized from the sale of other real estate owned through foreclosure and, actually realized net pre-tax losses of $793,000 during 2009 as compared to net pre-tax gains of $67,000 and $209,000 for the years ended December 31, 2008 and 2007, respectively. With continued and prolonged deterioration in real estate markets, the Company has sought to dispose of properties when economically possible rather than continue to hold them and incur ongoing carrying costs to maintain the properties.

Shared appreciation income has fluctuated over the three years presented, with decreases of $242,000 between 2008 and 2009, as compared to increases of $223,000 between 2007 and 2008. Shared appreciation income results from agreements between the

Company and the borrower on certain construction loans where the Company agrees to receive interest on the loan at maturity rather than monthly and the borrower agrees to share in the profits of the project. The profit is determined by the appraised value of the completed project and subsequent refinancing or sale of the project. Due to the difficulty in calculating future values, shared appreciation income is recognized when received. The Company does not participate in a significant number of shared appreciation projects, and as a result, does not anticipate large amounts of shared appreciation income on an ongoing basis.

Noninterest Expense

The following table sets forth the components of total noninterest expense in dollars and as a percentage of average earning assets for the years ended December 31, 2009, 2008 and 2007:

	2009		2008		2007	
(Dollars in thousands)	Amount	% of Average Earning Assets	Amount	% of Average Earning Assets	Amount	% of Average Earning Assets
Salaries and employee benefits	$ 8,551	1.36%	$ 10,610	1.53%	$ 10,830	1.56%
Occupancy expense	3,692	0.59%	3,954	0.57%	3,787	0.55%
Data processing	102	0.02%	279	0.04%	420	0.06%
Professional fees	2,201	0.35%	1,482	0.21%	1,811	0.26%
FDIC/DFI assessments	1,203	0.19%	535	0.08%	186	0.03%
Directors fees	253	0.04%	262	0.04%	268	0.04%
Amortization of intangibles	885	0.14%	972	0.14%	1,021	0.15%
Correspondent bank service charges	362	0.06%	427	0.06%	476	0.07%
Writedown on investment	0	0.00%	23	0.00%	34	0.00%
Impairment loss on OREO	1,324	0.21%	887	0.13%	0	0.00%
Impairment loss on intangible assets	81	0.01%	648	0.09%	0	0.00%
Impairment loss on Goodwill	3,026	0.48%	0	0.00%	0	0.00%
Impairment loss on investment securities	843	0.13%	0	0.00%	0	0.00%
Loss on lease assets held for sale	0	0.00%	0	0.00%	820	0.12%
Loss on CA Tax Credit Partnership	428	0.07%	432	0.06%	430	0.06%
OREO expense	1,612	0.26%	418	0.06%	209	0.03%
Other	3,403	0.54%	2,422	0.35%	1,923	0.28%
Total	$ 27,966	4.45%	$ 23,351	3.37%	$ 22,215	3.21%

Noninterest expense, excluding provision for credit losses and income tax expense, totaled $28.0 million for the year ended December 31, 2009 as compared to $23.4 million and $22.2 million for the years ended December 31, 2008 and 2007, respectively. These figures represent an increase of $4.6 million or 19.8% between the years ended December 31, 2008 and 2009 and an increase of $1.1 million or 5.1% between the years ended December 31, 2007 and 2008. As a percentage of average earning assets, total noninterest expense has remained relatively stable over the past three years, but increased slightly, as the Company has successfully controlled overhead expenses in a challenging economic environment. Noninterest expense amounted to 4.45% of average earning assets for the year ended December 31, 2009 as compared to 3.37% at December 31, 2008 and 3.11% at December 31, 2007

The net increase in noninterest expense between the years ended December 31, 2008 and 2009 is in large part the result of $3.0 million in goodwill impairment losses taken during second quarter of 2009. Other changes in noninterest expense are comprised of reductions in salaries and bonus incentives of nearly $2.1 million, and reductions in occupancy and data processing costs of $262,000, which were more than offset by increases in OREO impairment and overhead costs, legal fees, FDIC insurance assessments, and other expenses associated with nonperforming and foreclosed loans, as well as changes in the components of other impairment losses taken on various assets of the Company. As the economy has declined over the past year, the Company has streamlined certain departments to more effectively control salary and employee benefit costs where the levels of business are lower than they have been historically. The increase of $981,000 in other noninterest expense between the years ended December 31, 2009 and 2008 is primarily the result of a legal settlement totaling $800,000 for a disputed ATM servicing contract with a third-party servicer.

While impairment losses on intangible assets decreased $567,000 or 87.5% between the years ended December 31, 2008 and 2009, additional impairment losses were recorded during 2009 on other of the Company’s assets. Impairment losses totaling $1.3 million were realized on OREO during 2009 as OREO properties were further written-down to fair value as new valuations were received. In addition, during the year ended December 31, 2009, the Company recognized $843,000 in impairment losses ($163,000 during the first quarter, $240,000 during the second quarter, $317,000 during the third quarter, and $123,000 during the fourth quarter of 2009) on three of its non-agency collateralized mortgage obligations which were determined to be other-than-temporarily impaired. The amount expensed as impairment losses on the three securities represents the identified credit-related portion of the impairment. Although there are some indications of improvement in current economic conditions, a prolonged recessionary period could result in additional impairment losses in the future.

Increases in noninterest expense between the years ended December 31, 2007 and December 31, 2008 include impairment losses of $887,000 on OREO, and $648,000 on intangible assets. With economic conditions deteriorating during 2008, increased emphasis has been placed on impairment review, as the values on many assets have declined. Impairment losses on OREO properties are also a function of an increase in the volume of OREO acquired during 2008, which is also reflected in the increase of $209,000 in OREO expense during 2008. Decreases in noninterest expense have been realized in many categories during 2008 including a decrease of $220,000 in salary expense, $141,000 in data processing expense, and $329,000 in professional fees. The decrease in salary expense between the years ended December 31, 2007 and December 31, 2008 is primarily the result of a reduction in bonuses and incentives paid during 2008, many of which are based upon the Company’s net income.

During the years ended December 31, 2009, 2008, and 2007, the Company recognized stock-based compensation expense of $53,000 (less than $0.01 per share basic and diluted), $110,000 ($0.01 per share basic and diluted), and $187,000 ($0.02 per share basic and diluted), respectively. This expense is included in noninterest expense under salaries and employee benefits. Under the current pool of stock options, the Company expects stock-based compensation expense to be about $6,000 per quarter for 2010, and decline after that through 2011. If new stock options are issued, or existing options fail to vest due, for example, to forfeiture, actual stock-based compensation expense in future periods will change.

Income Taxes

The Company’s income tax expense is impacted to some degree by permanent taxable differences between income reported for book purposes and income reported for tax purposes, as well as certain tax credits which are not reflected in the Company’s pretax income or loss shown in the statements of operations and comprehensive income. As pretax income or loss amounts become smaller, the impact of these differences become more significant and are reflected as variances in the Company’s effective tax rate for the periods presented. In general, the permanent differences and tax credits affecting tax expense have a positive impact and tend to reduce the effective tax rates shown in the Company’s statements of operations and comprehensive income.

The Company reviews its current tax positions at least quarterly based accounting standards related to uncertainty in income taxes which includes the criteria that an individual tax position would have to meet for some or all of the income tax benefit to be recognized in a taxable entity’s financial statements. Under the income tax guidelines, an entity should recognize the financial statement benefit of a tax position if it determines that it is more likely than not that the position will be sustained on examination. The term “more likely than not” means a likelihood of more than 50 percent.” In assessing whether the more-likely-than-not criterion is met, the entity should assume that the tax position will be reviewed by the applicable taxing authority.

On December 31, 2003 the California Franchise Tax Board (FTB) announced certain tax transactions related to real estate investment trusts (REITs) and regulated investment companies (RICs) will be disallowed pursuant to Senate Bill 614 and Assembly Bill 1601, which were signed into law in the 4th quarter of 2003. As a result, the Company reversed related net state tax benefits recorded in the first three quarters of 2003 and has taken no related tax benefits since that time. The Company continues to review the information available from the FTB and its financial advisors and believes that the Company's position has merit. The Company will pursue its tax claims and defend its use of these entities and transactions. At this time, the Company cannot predict the ultimate outcome.

Pursuant to the guidance, the Company reviewed its REIT tax position as of January 1, 2007 (adoption date of the new guidance), and then has again reviewed its position each subsequent quarter since adoption. The Bank, with guidance from advisors, believes that the case has merit with regard to points of law, and that the tax law at the time allowed for the deduction of the consent dividend. However, the Bank, with the concurrence of advisors, cannot conclude that it is “more than likely” that the Bank will prevail in its case with the FTB. As a result of this determination, effective January 1, 2007 the Company recorded an adjustment of $1.3 million to beginning retained earnings upon adoption of the new guidance related to uncertainty in income taxes to recognize the potential tax liability under the guidelines of the interpretation. The adjustment includes amounts for assessed taxes, penalties, and interest. During the years ended December 31, 2008 and 2007, the Company increased the unrecognized tax liability by an additional $87,000 in interest for each of the two years, bringing the total recorded tax liability to $1.5 million at December 31, 2008. The Company has determined that there has been no material change to its position on the REIT from that at December 31, 2008, and as a result recorded additional interest liability of $87,000 during the year ended December 31, 2009. It is the Company's policy to recognize interest and penalties as a component of income tax expense. The Company has reviewed all of its tax positions as of December 31, 2009, and has determined that, other than the REIT, there are no other material amounts that should be recorded under the current income tax accounting guidelines.

Financial Condition

Total assets decreased by $68.5 million or 9.0% during the year to $692.6 million at December 31, 2009, and decreased $79.1 million or 10.3% from the balance of $771.7 million at December 31, 2007. During the year ended December 31, 2009, decreases of $35.6 million were experienced in net loans as construction and real estate lending slowed and approximately $20.0 million in problem loans were transferred to OREO, while another $10.1 million was charged off against the allowance for loan losses. Interest-bearing deposits in other banks and investment securities decreased by $17.1 million and $21.3 million, respectively, during the year ended December 31, 2009. Total deposits of $561.7 million at December 31, 2009 increased $53.2 million or 10.5% from the balance reported at December 31, 2008, and decreased $73.0 million or 11.5% from the balance of $634.6 million reported at December 31, 2007. Deposit growth during 2009 occurred in interest-bearing checking accounts and time deposits of $100,000 or more, while other deposit categories experienced declines between December 31, 2008 and December 31, 2009. Increases in time deposits during 2009 are in large part the result of additional brokered deposits which were obtained as the Company sought to reduce its dependence on overnight and term borrowings from the Federal Reserve and FHLB.

During 2008, net loans decreased $47.7 million, while interest-bearing deposits in other banks and investment securities increased $17.5 million and $3.3 million, respectively, between the two period-ends. During 2008, growth of $10.5 million and $13.4 million was experienced in noninterest-bearing deposits and time deposits of less than $100,000, respectively, which was more than offset by substantial declines in time deposits of $100,000 or more, and to a lesser degree interest-bearing checking and savings accounts. The decrease of $130.9 million in time deposits of $100,000 or more experienced during 2008 was primarily the result of brokered time deposits and deposits from the State of California, which were not renewed as they matured during 2008. The brokered time deposits were replaced with less expensive borrowings including FHLB advances and overnight borrowings from the Federal Reserve Discount Window.

Earning assets averaged approximately $628.6 million during the year ended December 31, 2009, as compared to $692.5 million and $678.0 million for the years ended December 31, 2008 and 2007, respectively. Average interest-bearing liabilities decreased to $513.8 million for the year ended December 31, 2009, as compared to $542.7 million for the year ended December 31, 2008, and decreased from the balance of $565.0 million for the year ended December 31, 2007.

Loans

The Company's primary business is that of acquiring deposits and making loans, with the loan portfolio representing the largest and most important component of its earning assets. Loans totaled $508.6 million at December 31, 2009, representing a decrease of $40.0 million or 6.6% when compared to the balance of $544.6 million at December 31, 2008, and a decrease of $84.2 million or 14.2% when compared to the balance of $592.8 million reported at December 31, 2007. Total loans decreased approximately $25.6 million during the fourth quarter of 2009, $4.7 million of which was the result of transfers of nonperforming loans to OREO, and another $4.2 million was the result of charge-offs against the reserve for loan and lease losses . Average loans totaled $534.8 million, $582.5 million, and $575.4 million for the years ended December 31, 2009, 2008 and 2007, respectively. During 2009 average loans decreased 8.2% when compared to the year ended December 31, 2008 and decreased 7.1% compared to the year ended December 31, 2007.

The following table sets forth the amounts of loans outstanding by category and the category percentages as of the year-end dates indicated:

	2009		2008		2007		2006		2005	
(In thousands)	Dollar Amount	% of Loans	Dollar Amount	% of Loans	Dollar Amount	% of Loans	Dollar Amount	% of Loans	Dollar Amount	% of Loans
Commercial and industrial	$ 167,930	33.0%	$ 188,207	34.6%	$ 188,826	31.9%	$ 146,964	29.7%	$ 111,904	27.1%
Real estate – mortgage	165,629	32.6	130,856	24.0	135,252	22.8	113,613	22.9	89,503	21.7
RE construction & development	105,220	20.7	151,091	27.7	200,836	33.8	176,825	35.7	163,953	39.8
Agricultural	50,897	10.0	52,020	9.6	46,387	7.8	35,502	7.1	25,214	6.1
Installment/other	18,191	3.6	20,782	3.8	18,171	3.1	16,712	3.4	15,002	3.6
Lease financing	706	0.1	1,595	0.3	3,323	0.6	5,507	1.1	6,889	1.7
Total Loans	$ 508,573	100.0%	$ 544,551	100.0%	$ 592,795	100.0%	$ 495,123	100.0%	$ 412,465	100.0%

Although the Company does not generally provide permanent financing for its construction and development loans, shorter-term permanent financing or "mini-perm" loans have been provided to a number of borrowers over the past several years as the current economic downturn has prolonged the development and completion of some projects. At the time of their renewal, some of these loans were classified as commercial and industrial loans because either the construction and development portion of the project had been delayed, or the project had been completed and the borrower opted to delay the sale of the completed project until market conditions improved. Some of the completed projects are currently providing rental income to the borrower. Upon review, it was determined that the Company had classified certain of its loans as commercial and industrial which, should have been classified as something other than commercial and industrial loans. As a result, at December 31, 2009, the Company retrospectively reclassified for reporting purposes forty-seven loans from commercial and industrial loans to either construction & land development, or commercial real estate loans, depending on whether they are partially completed, or are generating rental income. The reclassification had no impact on the Company's results of operations. The following summarizes the reclassification amounts for the periods prior to December 31, 2009 (in 000's).

Net changes in loans:	12/31/2008	12/31/2007	12/31/2006	12/31/2005
Commercial and industrial	$ (35,373)	$ (15,559)	$ (8,847)	$ (1,359)
Real estate mortgage	4,167	(7,312)	0	0
RE construction & development	31,206	22,539	8,447	1,080
Agricultural	0	332	400	279
Net change - total loans	$ 0	$ 0	$ 0	$ 0

Loan volume continues to be greatest in what has historically been the Bank's primary lending emphasis: commercial, real estate mortgage, and construction lending. With the continued deterioration of real estate markets during 2008 and 2009, the Company experienced a decrease of $45.9 million or 30.4 % in construction loans, and a decrease of $20.3 million or 10.81% in commercial and industrial loans, with minor decreases in installment as well as in agricultural loans. Lease financing decreased $889,000 during 2009, as the Company is no longer originating commercial leases. Partially offsetting these decreases were increases of $34.8 million in real estate mortgage loans, a portion of which were the result of construction loans which were completed or matured during the year and the borrower obtained longer-term financing from the Company. Approximately $20.0 million of the total $36.0 million decrease in loans experienced during the year ended December 31, 2009, was the result of nonperforming loans transferred to other real estate owned when all other means of settlement were exhausted.

During 2008, the Company experienced a decrease of $49.7 million or 24.8 % in construction loans, and decreases of $4.4 million and $619,000 in real estate mortgage loans, and commercial and industrial loans, respectively. Lease financing decreased $1.7 million during 2008, as the Company is no longer originating commercial leases. Partially offsetting these decreases were increases of $6.0 million in agricultural loans, and $2.6 million in consumer installment loans. Part of the decrease in construction and real estate loans experienced during 2008 is the result of transfers of approximately $28.5 million ($26.0 million net of charge-offs) in nonperforming loans to OREO.

During 2007 loan growth occurred in all categories except lease financing. During 2007, significant increases occurred in commercial and industrial loans, as well as real estate mortgage loans, with increases of $41.9 million or 28.5% and $21.6 million or 19.1% in those two categories, respectively. Agricultural loans increased $10.9 million or 30.7% during 2007, and real estate construction loans increased $24.0 million or 13.6% during 2007. The acquisition of Legacy Bank during February 2007 contributed approximately $63.9 million to the loan growth experienced during 2007. During the fourth quarter of 2007 loan volume declined approximately $27.7 million or 4.4% as the Company slowed additional loan growth as part of its asset/liability management and liquidity plan.

At December 31, 2009, approximately 74% of commercial and industrial loans have floating rates and, although some may be secured by real estate, many are secured by accounts receivable, inventory, and other business assets. Residential housing markets have suffered considerably since the later half of 2007, and as a result, residential construction loans decreased during 2008 and again during 2009. Real estate construction loans decreased $45.9 million or 30.4% during 2009, as compared to a decrease of $49.7 million or 24.8 % during 2008, and an increase of $24.0 million or 13.6% during 2007. Construction loans are generally short-term, floating-rate obligations, which consist of both residential and commercial projects. Agricultural loans consisting of mostly short-term, floating rate loans for crop financing, decreased $1.1 million or 6.0% between December 31, 2008 and December 31, 2009, while installment loans decreased $2.6 million or 12.5% during that same period.

The real estate mortgage loan portfolio totaling $165.6 million at December 31, 2009 consists of commercial real estate, residential mortgages, and home equity loans. Commercial real estate is the core of this segment of the portfolio, with balances of $117.0 million, $86.0 million, and $95.1 million at December 31, 2009, 2008, and 2007, respectively. Commercial real estate loans are generally a mix of short to medium-term, fixed and floating rate instruments and, are mainly tied to commercial income and multi-family residential properties. The Company does not currently offer traditional residential mortgage loans, but may purchase mortgage portfolios. As a result of real estate mortgage purchases over the past several years, that portion of the portfolio has remained relatively stable with balances of $45.8 million, $41.6 million, and $37.2 million at December 31, 2009, 2008 and 2007, respectively. The Company also offers short to medium-term, fixed-rate, home equity loans, which totaled $2.8 million at December 31, 2009, $3.2 million at December 31, 2008, and $3.0 million at December 31, 2007.

The following table sets forth the maturities of the Bank's loan portfolio at December 31, 2009. Amounts presented are shown by maturity dates rather than repricing periods:

(In thousands)	Due in one year or less	Due after one Year through Five years	Due after Five years	Total
Commercial and agricultural	$ 117,097	$ 81,989	$ 19,741	$ 218,827
Real estate construction & development	78,941	25,302	977	105,220
	196,038	107,291	20,718	324,047
Real estate – mortgage	22,262	93,708	49,659	165,629
All other loans	6,191	10,396	2,310	18,897
Total Loans	$ 224,491	$ 211,395	$ 72,687	$ 508,573

For the year ended December 31, 2009, the average yield on loans was 5.83%, representing a decrease of 98 basis points when compared to the year ended December 31, 2008 and was a result of continued loan pricing pressures as market rates of interest remained at historical lows. The Bank’s loan portfolio is generally comprised of short-term or floating rate loans and is therefore susceptible to fluctuations in market rates of interest.

The average yield on loans was 6.75% for the year ended December 31, 2008, representing a decrease of 232 basis points when compared to the year ended December 31, 2007 and was a result of a significant decrease in market rates of interest during 2008. The average loan yield for 2008 was also impacted by the reversal of approximately $1.0 million in interest on nonaccrual loans, reducing the average loan yield by 17 basis points for the year ended December 31, 2008.

For the year ended December 31, 2007, the average yield on loans was 9.07%, representing a decrease of 6 basis points when compared to the year ended December 31, 2006 and was a result of increased loan pricing pressures experienced during 2007 which more than outweighed an average increase of 9 basis point in the prime rate between the year ended December 31, 2006 and December 31, 2007. The Bank’s loan portfolio is generally comprised of short-term or floating rate loans and is therefore susceptible to fluctuations in market rates of interest.

At December 31, 2009, 2008 and 2007, approximately 60.7%, 64.0% and 62.3% of the Bank's loan portfolio consisted of floating rate instruments, with the majority of those tied to the prime rate.

The following table sets forth the contractual maturities of the Bank's fixed and floating rate loans at December 31, 2009. Amounts presented are shown by maturity dates rather than repricing periods, and do not consider renewals or prepayments of loans:

(In thousands)	Total

	Due in one year or less	Due after one Year through Five years	Due after Five years	
Accruing loans:				
Fixed rate loans	$ 12,898	$ 107,993	$ 60,093	$ 180,984
Floating rate loans	184,025	96,357	12,450	292,832
Total accruing loans	196,923	204,350	72,543	473,816
Nonaccrual loans:				
Fixed rate loans	14,266	2,095	28	16,389
Floating rate loans	13,302	4,950	116	18,368
Total nonaccrual loans	27,568	7,045	144	34,757
Total Loans	$ 224,491	$ 211,395	$ 72,687	$ 508,573

Securities

Following is a comparison of the amortized cost and approximate fair value of available-for-sale for the three years indicated:

(In thousands)	December 31, 2009 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)	December 31, 2008 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
Available-for-sale:								
U.S. Government agencies	$ 35,119	$ 1,469	$ (2)	$ 36,586	$ 43,110	$ 1,280	$ (204)	$ 44,186
U.S Gov't agency collateralized mortgage obligations	14,954	376	(10)	15,320	21,317	189	(40)	21,466
Residential mortgage obligations	14,273	0	(4,559)	9,714	17,751	0	(4,951)	12,800
Obligations of state and political subdivisions	1,252	33	0	1,285	1,252	28	0	1,280
Other investment securities	9,004	0	(498)	8,506	13,880	0	(863)	13,017
Total available-for-sale	$ 74,602	$ 1,878	$ (5,069)	$ 71,411	$ 97,310	$ 1,497	$ (6,058)	$ 92,749

(In thousands)	December 31, 2007 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Government agencies	$ 65,764	$ 524	$ (302)	$ 65,986
Collateralized mortgage obligations	7,782	44	(4)	7,822
Obligations of state and political subdivisions	2,227	54	0	2,281
Other investment securities	13,752	0	(426)	13,326
Total available-for-sale	$ 89,525	$ 622	$ (732)	$ 89,415

Included in other investment securities at December 31, 2009, is a short-term government securities mutual fund totaling $7.5 million, and an overnight money-market mutual fund totaling $1.0 million. Included in other investment securities at December 31, 2007, is a short-term government securities mutual fund totaling $7.7 million, a CRA-qualified mortgage fund totaling $4.9 million, and an overnight money-market mutual fund totaling $752,000. Included in other investment securities at December 31, 2006, is a short-term government securities mutual fund totaling $7.7 million, and a CRA-qualified mortgage fund totaling $4.8 million. The commercial asset-backed trust consists of fixed and floating rate commercial and multifamily mortgage loans. The short-term government securities mutual fund invests in debt securities issued or guaranteed by the U.S. Government, its agencies or instrumentalities, with a maximum duration equal to that of a 3-year U.S. Treasury Note.

There were no realized gains, but there were realized losses on available-for-sale securities totaling $37,000 for the year ended December 31, 2009. There were realized gains on available-for-sale securities totaling $24,000 and

$27,000 for the years ended December 31, 2008 and 2006, respectively. There were no realized gains or losses on securities available-for-sale during 2007. There were no realized losses on securities available-for-sale during 2008 or 2006.

Investment securities decreased $21.3 million between December 2008 and December 2009, as maturities and pay-downs from investment securities were not reinvested in the securities portfolio but were instead utilized to reduce overnight and term borrowings. In addition, one mutual fund with a carrying cost of $5.0 million was sold during the fourth quarter of 2009 to provide additional liquidity. Investment securities increased $3.3 million between December 2007 and December 2008, as U.S. government agencies and municipal bonds were either paid down or matured, and additional funds from maturing loans were utilized to purchase additional investment securities or interest-bearing deposits in other banks.

Securities that have been temporarily impaired less than 12 months at December 31, 2009 are comprised of two U.S. government agency securities and one collateralized mortgage obligation with a weighted average life of 1.90 years. As of December 31, 2009, there were three residential mortgage obligations, and one other investment security with a total weighted average life of 1.37 years that have been temporarily impaired for twelve months or more. At December 31, 2009, the decline in market value for all but three (see below) of the impaired securities is attributable to changes in interest rates and illiquidity, and not credit quality. Because the Company does not have the intent to sell these impaired securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired at December 31, 2009.

At December 31, 2009, the Company had three non-agency residential mortgage obligations which have been impaired more than twelve months. All three residential mortgage obligations were rated less than high credit quality at December 31, 2009. The residential mortgage obligations had a market value of $9.7 million and unrealized losses of approximately $4.6 million at December 31, 2009. The Company evaluated these three residential mortgage obligations for OTTI by comparing the present value of expected cash flows to previous estimates to determine whether there had been adverse changes in cash flows during the quarter. The OTTI evaluation was conducted utilizing the services of a third party specialist and consultant in MBS and CMO products. The cash flow assumptions used in the evaluation included a number of factors including changes in delinquency rates, anticipated prepayment speeds, loan-to-value ratios, changes in agency ratings, and market prices. As a result of the impairment evaluation, the Company determined that there had been adverse changes in cash flows during the quarter for all three of the residential mortgage obligations reviewed, and concluded that these three investments were other-than-temporarily impaired. During the fourth quarter of 2009, the three residential mortgage obligations had other-than-temporary-impairment losses of $4.7 million, of which $123,000 was recorded as expense and $4.6 million was recorded in other comprehensive loss. On a year-to-date basis, the three residential mortgage obligations had other-than-temporary-impairment losses of $5.4 million, of which $843,000 was recorded as expense and $4.6 million was recorded in other comprehensive loss. The three residential mortgage obligations remained classified as available for sale at December 31, 2009.

The following summarizes temporarily impaired investment securities at December 31, 2009

	Less than 12 Months		12 Months or More		Total	
(In thousands) Securities available for sale:	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses
U.S. Government agencies	$ 1,498	$ (2)	$ 0	$ 0	$ 1,498	$ (2)
U.S. Government agency collateral mortgage obligations	2,236	(10)	0	0	2,236	(10)
Residential mortgage obligations	0	0	9,714	(4,559)	9,714	(4,559)
Obligations of state and political subdivisions	0	0	0	0	0	0
Other investment securities	0	0	7,502	(498)	7,502	(498)
Total impaired securities	$ 3,734	$ (12)	$ 17,216	$ (5,057)	$ 20,950	$ (5,069)

Securities that have been temporarily impaired less than 12 months at December 31, 2008 are comprised of three residential mortgage obligations and one collateralized mortgage obligation with a weighted average life of 3.66 years, and seven U.S. agency bonds with a weighted average life of 3.18 years. As of December 31, 2008, there were two other investment securities with a total weighted average life of 0.50 years that have been temporarily impaired for twelve months or more. The unrealized losses are due in most part to interest rate changes, as well as credit downgrades in some of the portfolio including three collateralized mortgage obligations. The Company has the ability and intent to hold all investment securities with identified impairments resulting from interest rate changes and credit downgrades to the earlier of the forecasted recovery or the maturity of the underlying investment security. The Company believes that credit downgrades on securities within the portfolio are a result of the severity of the current economic downturn and does not believe the downgrades will result in permanent impairment of those securities. As a result, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2008.

The following summarizes temporarily impaired investment securities at December 31, 2008

(In thousands) Securities available for sale:	Less than 12 Months Fair Value (Carrying Amount)	Less than 12 Months Unrealized Losses	12 Months or More Fair Value (Carrying Amount)	12 Months or More Unrealized Losses	Total Fair Value (Carrying Amount)	Total Unrealized Losses
U.S. Government agencies	$ 6,471	$ (204)	$ 0	$ 0	$ 6,471	$ (204)
U.S. Government agency collateral mortgage obligations	4,768	(40)	0	0	4,768	(40)
Residential mortgage obligations	12,800	(4,951)	0	0	12,800	(4,951)
Obligations of state and political subdivisions	0	0	0	0	0	0
Other investment securities	0	0	12,137	(863)	12,137	(863)
Total impaired securities	$ 24,039	$ (5,195)	$ 12,137	$ (863)	$ 36,176	$ (6,058)

Securities that have been temporarily impaired less than 12 months at December 31, 2007 are comprised of one U.S. government agency collateralized mortgage obligation with a weighted average life of 1.19 years. As of December 31, 2007, there were nine U.S. government agency securities, and two other investment securities with a total weighted average life of 0.97 years that have been temporarily impaired for twelve months or more. Because the decline in market value is attributable to changes in market rates of interest rather than credit quality, and because the Company has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2007.

The following summarizes temporarily impaired investment securities at December 31, 2007

(In thousands) Securities available for sale:	Less than 12 Months Fair Value (Carrying Amount)	Less than 12 Months Unrealized Losses	12 Months or More Fair Value (Carrying Amount)	12 Months or More Unrealized Losses	Total Fair Value (Carrying Amount)	Total Unrealized Losses
U.S. Government agencies	$ 0	$ 0	$ 30,241	$ (302)	$ 30,241	$ (302)
Collateralized mortgage obligations	4,129	(4)	0	0	4,129	(4)
Obligations of state and political subdivisions	0	0	0	0	0	0
Other investment securities	0	0	12,574	(426)	12,574	(426)
Total impaired securities	$ 4,129	$ (4)	$ 42,815	$ (728)	$ 46,944	$ (732)

The contractual maturities of investment securities as well as yields based on amortized cost of those securities at December 31, 2009 are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	One year or less Amount	One year or less Yield (1)	After one year to five years Amount	After one year to five years Yield (1)	After five years to ten years Amount	After five years to ten years Yield (1)	After ten years Amount	After ten years Yield (1)	Total Amount	Total Yield (1)
Available-for-sale:										
U.S. Government agencies	$ 0	---	$ 4,204	2.94%	$ 11,288	5.06%	$ 21,094	4.49%	$ 36,586	4.59%

U.S. Gov't agency collateralized mortgage obligations	---	---	2,162	4.68%	6,054	4.40%	7,104	5.79%	15,320	5.19%
Residential mortgage obligations	---	---	---	---	---	---	9,714	6.91%	9,714	6.91%
Obligations of state and political subdivisions	---	---	628	4.38%	657	4.72%	---	---	1,285	4.55%
Other investment securities	8,506	5.70%	---	---	---	---	---	---	8,506	5.70%
Total estimated fair value	$ 8,506	5.70%	$ 6,994	3.61%	$ 17,999	4.82%	$ 37,912	5.35%	$ 71,411	5.49%

(1) Weighted average yields are not computed on a tax equivalent basis

50

At December 31, 2009 and 2008, available-for-sale securities with an amortized cost of approximately $66.5 million and $81.4 million, respectively (fair value of $65.3 million and $79.6 million, respectively) were pledged as collateral for public funds, FHLB borrowings, and treasury tax and loan balances.

Deposits

The Bank attracts commercial deposits primarily from local businesses and professionals, as well as retail checking accounts, savings accounts and time deposits. Total deposits increased $53.2 million or 10.5% during the year to a balance of $561.7 million at December 31, 2009 and decreased $126.1 million or 19.9% between December 31, 2007 and December 31, 2008. Core deposits, consisting of all deposits other than time deposits of $100,000 or more and brokered deposits, continue to provide the foundation for the Bank's principal sources of funding and liquidity. These core deposits amounted to 66.7%, 71.9% and 59.9% of the total deposit portfolio at December 31, 2009, 2008 and 2007, respectively.

The following table sets forth the year-end amounts of deposits by category for the years indicated, and the dollar change in each category during the year:

	December 31,			Change during Year	
(In thousands)	2009	2008	2007	2009	2008
Noninterest-bearing deposits	$ 139,724	$ 149,529	$ 139,066	$ (9,805)	$ 10,463
Interest-bearing deposits:					
NOW and money market accounts	158,795	136,612	153,717	22,183	(17,105)
Savings accounts	34,146	37,586	40,012	(3,440)	(2,426)
Time deposits:					
Under $100,000	64,481	66,128	52,297	(1,647)	13,831
$100,000 and over	164,514	118,631	249,525	45,883	(130,894)
Total interest-bearing deposits	421,936	358,957	495,551	62,979	(136,594)
Total deposits	$ 561,660	$ 508,486	$ 634,617	$ 53,174	$ (126,131)

During the year ended December 31, 2009, increases were experienced in interest-bearing checking accounts and time deposits of $100,000 or more, while other deposit categories experienced small decreases. The Company increased brokered deposits during 2009 as part of its liquidity strategy to reduce dependence on overnight and term borrowings from the Federal Reserve and FHLB. Although pricing on borrowing remains attractive, access to credit lines has become more vulnerable as risk profiles of most banks have increased in the current economic environment. Pricing of brokered time deposits and other wholesale deposits remain extremely low at this time and currently provides a viable alternate to borrowings from the Federal Reserve or the FHLB. The Company believes this rate structure will eventually turn, and wholesale funding sources, both deposits and borrowings, will again become expensive relative to other core deposits in the marketplace. The Company will continue to use pricing strategies to control the overall level of time deposits and other borrowings as part of its growth and liquidity planning process, but will continue to emphasize core deposits as part of its long-term relationship banking strategy. As a result, core deposits, including NOW and money market accounts, and savings accounts, as well as noninterest-bearing checking accounts, continue to provide the Company’s primary funding source.

During the year ended December 31, 2008, decreases were experienced primarily in time deposits, and to a lesser degree in interest-bearing checking accounts and saving accounts. Brokered and other time deposits were allowed to runoff as they matured during 2008, as the Company sought other less-expensive funding sources including FHLB advances and overnight borrowings from the Federal Reserve. In addition, time deposits from the State of California, which totaled $45.0 million at both December 31, 2007 and December 31, 2006, were not renewed by the State of California during 2008. The Company had increased brokered deposits throughout 2007 as part of its liquidity strategy begun during 2006 to fund loan growth as core deposits became increasingly difficult to obtain and pricing became more competitive. As market rates of interest declined during 2008, brokered deposit pricing did not decline to the same degree, due largely to liquidity and credit issues in the market place. As a result, brokered deposits and other time deposits became less attractive as a funding source. NOW and money market accounts, as well as savings accounts declined $17.1 million and $2.4 million, respectively, between December 31, 2007 and December 31, 2008 as these deposits remain competitive.

During the year ended December 31, 2007 increases were experienced primarily in time deposits, and to a lesser degree in saving accounts. Increases in time deposits during 2007 were largely the result brokered time deposits obtained by the Company as part of its liquidity strategy begun during 2006 to fund loan growth as core deposits became increasingly difficult to obtain and pricing became more competitive. This liquidity strategy allowed the Company to obtain the additional funding sources needed during 2007 to fund loan growth without adversely impacting the cost of its core deposit base. NOW and money market accounts, as well as noninterest-bearing deposits declined $30.7 million and $19.9 million, respectively, between December 31, 2006 and December 31, 2007 as these deposits became increasingly competitive.

The Company's deposit base consists of two major components represented by noninterest-bearing (demand) deposits and interest-bearing deposits. Interest-bearing deposits consist of time certificates, NOW and money market accounts and savings deposits. Between December 31, 2008 and December 31, 2009, total interest-bearing deposits increased $63.0 million or 17.5%, while noninterest-bearing deposits decreased $19.8 million or 6.6%. Total noninterest-bearing deposits increased $10.5 million or 7.5% between December 31, 2007 and December 31, 2008, while interest-bearing deposits decreased $136.6 million or 27.6% between the same two periods presented.

On a year-to-date average, the Company experienced a decrease of $46.3 million or 7.9 % in total deposits between the years ended December 31, 2008 and December 31, 2009. Between these two periods, average interest-bearing deposits decreased $36.4 million or 8.3%, while total noninterest-bearing checking decreased $9.8 million or 6.8% on a year-to-date average basis. On average, the Company experienced increases in NOW between the years ended December 31, 2008 and December 31, 2009, while other deposit categories experienced moderate declines on average during 2009. On a year-to-date average basis, total deposits decreased $56.1 million or 8.8% between the years ended December 31, 2007 and December 31, 2008. Of that total, interest-bearing deposits decreased by $53.9 million or 10.9%, while noninterest-bearing deposits decreased $2.2 million or 1.5% during 2008. On average, the Company experienced decreases in all deposit categories between the years ended December 31, 2007 and December 31, 2008.

The following table sets forth the average deposits and average rates paid on those deposits for the years ended December 31, 2009, 2008 and 2007:

	2009		2008		2007	
(Dollars in thousands)	Average Balance	Rate %	Average Balance	Rate %	Average Balance	Rate %
Interest-bearing deposits:						
Checking accounts	$ 161,711	1.48%	$ 167,190	1.91%	$ 183,102	2.48%
Savings	35,228	0.62%	40,699	1.18%	46,225	1.91%
Time deposits (1)	205,261	1.75%	230,746	3.65%	263,196	4.94%
Noninterest-bearing deposits	134,925		144,772		146,954	

(1) Included at December 31, 2009, are $164.5 million in time certificates of deposit of $100,000 or more, of which $76.2 million matures in three months or less, $63.6 million matures in 3 to 6 months, $19.2 million matures in 6 to 12 months, and $5.5 million matures in more than 12 months.

Short-term Borrowings

The Company has the ability to obtain borrowed funds consisting of federal funds purchased, securities sold under agreements to repurchase (“repurchase agreements”) and Federal Home Loan Bank (“FHLB”) advances as alternatives to retail deposit funds. The Company has established collateralized and uncollateralized lines of credit with several correspondent banks, as well as a securities dealer, for the purpose of obtaining borrowed funds as needed. The Company may continue to borrow funds in the future as part of its asset/liability strategy, and may use these funds to acquire certain other assets as deemed appropriate by management for investment purposes and to better utilize the capital resources of the Bank. Federal funds purchased represent temporary overnight borrowings from correspondent banks and are generally unsecured. Repurchase agreements are collateralized by mortgage backed securities and securities of U.S. Government agencies, and generally have maturities of one to six months, but may have longer maturities if deemed appropriate as part of the Company’s asset/liability management strategy. FHLB advances are collateralized by the Company’s investment in FHLB stock, securities, and certain qualifying mortgage loans. In addition, the Company has the ability to obtain borrowings from the Federal Reserve Bank of San Francisco, which would be collateralized by certain pledged loans in the Company’s loan portfolio. The lines of credit are subject to periodic review of the Company’s financial statements by the grantors of the credit lines. Lines of credit may be modified or revoked at any time if the grantors feel there are adverse trends in the Company’s financial position.

The Company had collateralized and uncollateralized lines of credit aggregating $124.2 million and $242.7 million, as well as FHLB lines of credit totaling $40.8 million and $97.1 million at December 31, 2009 and 2008, respectively. At December 31, 2009, the Company had total outstanding balances of $40.0 million drawn against its FHLB line of credit. Of the $40.0 million in FHLB borrowings outstanding at December 31, 2009, all mature within three months and have an average rate of 0.86. These lines of credit generally have interest rates tied to the Federal Funds rate or are indexed to short-term U.S. Treasury rates or LIBOR.

The table below provides further detail of the Company’s federal funds purchased, repurchase agreements and FHLB advances for the years ended December 31, 2009, 2008 and 2007:

	December 31,		
(Dollars in thousands)	2009	2008	2007
At period end:			
Federal funds purchased	$ 0	$ 66,545	$ 10,380
Repurchase agreements	0	0	0
FHLB advances	40,000	88,500	21,900
Total at period end	$ 40,000	$ 155,045	$ 32,280
Average ending interest rate – total	0.86%	0.93%	4.10%
Average for the year:			
Federal funds purchased	$ 40,443	$ 58,432	$ 4,660
Repurchase agreements	0	0	0
FHLB advances	59,434	32,937	13,231
Total average for the year	$ 99,877	$ 91,369	$ 17,891
Average interest rate – total	0.80%	2.32%	5.17%
Maximum total borrowings outstanding at any month-end during the year:			
Federal funds purchased	$ 87,530	$ 160,083	$ 16,400
Repurchase agreements/FHLB advances	73,700	28,000	20,000
Total	$ 161,230	$ 188,083	$ 36,400

Asset Quality and Allowance for Credit Losses

Lending money is the Company's principal business activity, and ensuring appropriate evaluation, diversification, and control of credit risks is a primary management responsibility. Implicit in lending activities is the fact that losses will be experienced and that the amount of such losses will vary from time to time, depending on the risk characteristics of the loan portfolio as affected by local economic conditions and the financial experience of borrowers.

The allowance for credit losses is maintained at a level deemed appropriate by management to provide for known and inherent risks in existing loans and commitments to extend credit. The adequacy of the allowance for credit losses is based upon management's continuing assessment of various factors affecting the collectibility of loans and commitments to extend credit; including current economic conditions, past credit experience, collateral, and concentrations of credit. There is no precise method of predicting specific losses or amounts which may ultimately be charged off on particular segments of the loan portfolio. The collectibility of a loan is subjective to some degree, but must relate to the borrower’s financial condition, cash flow, quality of the borrower’s management expertise, collateral and guarantees, and the state of the local economy. When determining the adequacy of the allowance for credit losses, the Company follows, in accordance with GAAP, the guidelines set forth in the Interagency Policy Statement on the Allowance for Loan and Lease Losses (“Statement”) issued jointly by banking regulators during 2003, and updated and revised in 2006. The Statement outlines characteristics that should be used in segmentation of the loan portfolio for purposes of the analysis including risk classification, past due status, type of loan, industry or collateral. It also outlines factors to consider when adjusting the loss factors for various segments of the loan portfolio. Securities and Exchange Commission Staff Accounting Bulletin No. 102 was also released at this time which represents the SEC staff’s view relating to methodologies and supporting documentation for the Allowance for Loan and Lease Losses that should be observed by all public companies in complying with the federal securities laws and the Commission’s interpretations. It is also generally consistent with the guidance published by the banking regulators.

The allowance for loan losses includes an asset-specific component, as well as a general or formula-based component. The Company segments the loan and lease portfolio into eleven (11) segments, primarily by loan class and type, that have homogeneity and commonality of purpose and terms for analysis under the formula-based component of the allowance. Those loans which are determined to be impaired under current accounting guidelines are not subject to the formula-based reserve analysis, and evaluated individually for specific impairment under the asset-specific component of the allowance. The eleven segments of the Company's loan portfolio are as follows (subtotals are provided as needed to allow the reader to reconcile the amounts to the Company's loan classification reported elsewhere in these financial statements):

Loan Segments for Loan Loss Reserve Analysis (dollars in 000's)		Loan Balance at December 31, 2009	2008	2007	2006	2005
1	Commercial and Business Loans	$ 161,292	$ 180,750	$ 181,123	$ 143,223	$ 108,424
2	Government Program Loans	6,638	7,457	7,703	3,741	3,480
	Total Commercial and Industrial	167,930	188,207	188,826	146,964	111,904
3	Commercial Real Estate Term Loans	117,010	86,007	95,085	71,697	43,644
4	Single Family Residential Loans	45,828	41,608	37,195	39,184	43,308
5	Home Improvement/Home Equity Loans	2,791	3,241	2,972	2,732	2,551
	Total Real Estate Mortgage	165,629	130,856	135,252	113,613	89,503
6	Total Real Estate Construction Loans	105,220	151,091	200,836	176,825	163,953
7	Total Agricultural Loans	50,897	52,020	46,387	35,502	25,214
8	Consumer Loans	17,939	20,370	17,521	16,327	14,373
9	Overdraft protection Lines	73	80	85	82	102
10	Overdrafts	179	332	565	303	527
	Total Installment/other	18,191	20,782	18,171	16,712	15,002
11	Total Lease Financing	706	1,595	3,323	5,507	6,889
	Total Loans	$ 508,573	$ 544,551	$ 592,795	$ 495,123	$ 412,465

The Company’s methodology for assessing the adequacy of the allowance for credit losses consists of several key elements, which include:

- the formula allowance,

- specific allowances for problem graded loans (“classified loans”)

- and the unallocated allowance

In addition, the allowance analysis also incorporates the results of measuring impaired loans as provided current accounting standards for contingencies.

The formula allowance is calculated by applying loss factors to outstanding loans and certain unfunded loan commitments. Loss factors are based on the Company’s historical loss experience and on the internal risk grade of those loans and, may be adjusted for significant factors that, in management's judgment, affect the collectibility of the portfolio as of the evaluation date. Factors that may affect collectibility of the loan portfolio include:

- Levels of, and trends in delinquencies and nonaccrual loans;
- Trends in volumes and term of loans;
- Effects of any changes in lending policies and procedures including those for underwriting, collection, charge-off, and recovery;
- Experience, ability, and depth of lending management and staff;
- National and local economic trends and conditions and;
- Concentrations of credit that might affect loss experience across one or more components of the portfolio, including high-balance loan concentrations and participations.

Management determines the loss factors for problem-graded loans (substandard, doubtful, and loss), special mention loans, and pass graded loans, based on a loss migration model. The migration analysis incorporates loan losses over the past twelve quarters (three years) and loss factors are adjusted to recognize and quantify the loss exposure from changes in market conditions and trends in the Company's loan portfolio. For purposes of this analysis, loans are grouped by internal risk classifications, which are "pass", "special mention", "substandard", "doubtful", and "loss." Certain loa are homogenous in nature and are therefore pooled by risk grade. These homogenous loans include consumer installment and home equity loans. Special mention loans are currently performing but are potentially weak, as the borrower has begun to exhibit deteriorating trends, which if not corrected, could jeopardize repayment of the loan and result in further downgrade. Substandard loans have well-defined weaknesses which, if not corrected, could jeopardize the full satisfaction of the debt. A loan classified as "doubtful" has critical weaknesses that make full collection of the obligation improbable. Classified loans, as defined by the Company, include loans categorized as substandard, doubtful, and loss. At December

31, 2009, problem graded or “classified” loans totaled $69.6 million or 13.7% of gross loans, as compared to $85.3 million or 16.0% of gross loans at September 30, 2009, and $82.7 million or 15.2% of gross loans at December 31, 2008.

Loan participations are reviewed for allowance adequacy under the same guidelines as other loans in the Company’s portfolio, with an additional participation factor added, if required, for specific risks associated with participations. In general, participations are subject to certain thresholds set by the Company, and are reviewed for geographic location as well as the well-being of the underlying agent bank.

The formula allowance includes reserves for certain off-balance sheet risks including letters of credit, unfunded loan commitments, and lines of credit. Reserves for undisbursed commitments are generally formula allocations based on the Company’s historical loss experience and other loss factors, rather than specific loss contingencies. At December 31, 2009, 2008 and 2007 the formula reserve allocated to undisbursed commitments totaled $234,000, $313,000 and $548,000, respectively. The reserve for unfunded commitments is considered a reserve for contingent liabilities and is therefore carried as a liability on the balance sheet for all periods presented.

Specific allowances are established based on management’s periodic evaluation of loss exposure inherent in classified loans, impaired loans, and other loans in which management believes there is a probability that a loss has been incurred in excess of the amount determined by the application of the formula allowance. For impaired loans, specific allowances are determined based on the collateralized value of the underlying properties, the net present value of the anticipated cash flows, or the market value of the underlying assets. Formula allowances for classified loans excluding impaired loans, specific allowances, where required, are determined on the basis of additional risks involved with individual loans that may be in excess of risk factors associated with the loan portfolio as a whole. The specific allowance is different from the formula allowance in that the specific allowance is determined on a loan-by-loan basis based on risk factors directly related to a particular loan, as opposed to the formula allowance which is determined for a pool of loans with similar characteristics, based on past historical trends and other risk factors which may be relevant on an ongoing basis.

The unallocated portion of the allowance is the result of both expected and unanticipated changes in various conditions that are not directly measured in the determination of the formula and specific allowances. The conditions may include, but are not limited to, general economic and business conditions affecting the key lending areas of the Company, credit quality trends, collateral values, loan volumes and concentrations, and other business conditions.

The following table summarizes the specific allowance, formula allowance, and unallocated allowance at December 31, 2009, September 30, 2009 and December 31, 2008.

(in 000's)	Balance December 31, 2009	Balance September 30, 2009	Balance December 31, 2008
Specific allowance – impaired loans	$ 7,974	$ 7,687	$ 4,972
Formula allowance – classified loans not impaired	1,979	1,248	2,113
Formula allowance – special mention loans	587	767	752
Total allowance for special mention and classified loans	10,540	9,702	7,837
Formula allowance for pass loans	4,476	4,702	3,550
Unallocated allowance	0	9	142
Total allowance	$ 15,016	$ 14,413	$ 11,529
Impaired loans	$ 53,794	$ 73,762	$ 48,946
Classified loans not considered impaired	15,816	11,670	33,758

Total classified loans	$	69,610	$	85,432	$	82,704
Special mention loans	$	27,939	$	40,505	$	32,285

Impaired loans increased approximately $4.8 million between December 31, 2008 and December 31, 2009, but decreased approximately $20.0 million during the quarter ended December 31, 2009. The specific allowance related to impaired loans increased $3.0 million and $287,000 for the year ended and quarter ended December 31, 2009, respectively. The formula allowance related to loans that are not impaired (including special mention and substandard) decreased approximately $299,000 between December 31, 2008 and December 31, 2009, and decreased $551,000 during the quarter ended December 31, 2009. Increases for the year ended December 31, 2009 were the result of increases in adjusting factors for current economic trends and conditions, and trends in delinquent and nonaccrual loans, as well as increased asset-specific reserves on certain loan relationships. Even though the level of "pass" loans decreased approximately $16.7 million during the year ended December 31, 2009, the related formula allowance increased $926,000 during 2009 as a result of an increase in percentage loss allocations, as well as factor allocation increases due to current economic conditions.

At December 31, 2008, the Company segregated approximately $26.3 million of the total $33.8 million in substandard classified loans for purposes of the quarterly analysis of the adequacy of the allowance for credit losses under the formula allowance. Many of these loans had been downgraded to substandard because the borrowers had other direct or indirect lending relationships which were classified as substandard or impaired. The $26.3 million in substandard loans consisted of ten borrowing relationships, which although classified as substandard, the Company believed were performing and therefore did not warrant the same loss factors as other substandard loans in the portfolio. The adequacy of the allowance for credit losses related to this $26.3 million pool of substandard loans was based upon current payment history, loan-to-value ratios, future anticipated performance, and other various factors. The formula allowance for credit losses related to these substandard loans totaled $1.2 million at December 31, 2008. This formula reserve was previously included in the formula allowance for special mention and classified loans totaling $2.9 million at December 31, 2008 in the above table. During the second quarter of 2009, the performance of the segregated substandard loan portfolio deteriorated to a point where management determined that the loans were either impaired or subject to the higher loss factors traditionally applied to other substandard loans. As a result, approximately $16.8 million of the previously segregated substandard loans were transferred to impaired loans, and the remainder analyzed using applicable formula loss factors related to their risk ratings. The increase in the reserve for impaired loans related to this transfer totaled $1.8 million during the quarter ended June 30, 2009 and an increase of approximately $225,000 in other reserve categories during the same period.

The Company's methodology includes features that are intended to reduce the difference between estimated and actual losses. The specific allowance portion of the analysis is designed to be self-correcting by taking into account the current loan loss experience based on that portion of the portfolio. By analyzing the probable estimated losses inherent in the loan portfolio on a quarterly basis, management is able to adjust specific and inherent loss estimates using the most recent information available. In performing the periodic migration analysis, management believes that historical loss factors used in the computation of the formula allowance need to be adjusted to reflect current changes in market conditions and trends in the Company's loan portfolio. There are a number of other factors, which are reviewed when determining adjustments in the historical loss factors. They include 1) trends in delinquent and nonaccrual loans, 2) trends in loan volume and terms, 3) effects of changes in lending policies, 4) concentrations of credit, 5) competition, 6) national and local economic trends and conditions, 7) experience of lending staff, 8) loan review and Board of Directors oversight, 9) high balance loan concentration, and 10) other business conditions. Other than the reclassification of approximately $26.3 million in previously segregated substandard loans during 2009 discussed above, there were no changes in estimation methods or assumptions during 2009 that affected the methodology for assessing the overall adequacy of the allowance for credit losses.

Management and the Company's lending officers evaluate the loss exposure of classified and impaired loans on a weekly and monthly basis, and through discussions and officer meetings as conditions change. The Company's Loan Committee meets weekly and serves as a forum to discuss specific problem assets that pose significant concerns to the Company, and to keep the Board of Directors informed through committee minutes. All special mention and classified loans are reported quarterly on Criticized Asset Reports, which are reviewed by senior management. With this information, the migration analysis and the impaired loan analysis are performed on a quarterly basis and adjustments are made to the allowance as deemed necessary. As the real estate market and economic crisis became more severe beginning during the later part of 2008, the Company successfully worked with many of its borrowers to re-margin loans as collateral values declined, weakening the Company's credit position and increasing the potential for losses. This process of working with potentially troubled borrowers is monitored closely through the loan review process.

The specific allowance for impaired loans is measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. The amount of impaired loans is not directly comparable to the amount of nonperforming loans disclosed later in this section. The primary differences between impaired loans and nonperforming loans are: i) all loan categories are considered in determining nonperforming loans while impaired loan recognition is limited to commercial and industrial loans, commercial and residential real estate loans, construction loans, and agricultural loans, and ii) impaired loan recognition considers not only loans 90 days or more past due, restructured loans and nonaccrual loans but also may include problem loans other than delinquent loans.

The Company considers a loan to be impaired when, based upon current information and events, it believes it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans include nonaccrual loans, restructured debt, and performing loans in which full payment of principal or interest is not expected. Management bases the measurement of these impaired loans on the fair value of the loan's collateral or the expected cash flows on the loans discounted at the loan's stated interest rates. Cash receipts on impaired loans not performing to contractual terms and that are on nonaccrual status are used to reduce principal balances. Impairment losses are included in the allowance for credit losses through a charge to the provision, if applicable.

At December 31, 2009 and 2008, the Company's recorded investment in loans for which impairment has been recognized totaled $53.8 million and $48.9 million, respectively. Included in total impaired loans at December 31, 2009, are $26.3 million of impaired loans for which the related specific allowance is $8.0 million, as well as $27.5 million of impaired loans that as a result of write-downs or the fair value of the collateral, did not have a specific allowance. Total impaired loans at December 31, 2008 included $25.5 million of impaired loans for which the related specific allowance is $5.0 million, as well as $23.4 million of impaired loans that as a result of write-downs or the fair value of the collateral, did not have a specific allowance. The average recorded investment in impaired loans was $59.6 million, $31.7 million and $10.4 million during the years ended December 31, 2009, 2008 and 2007, respectively. In most cases, the Company uses the cash basis method of income recognition for impaired loans. In the case of certain troubled debt restructuring for which the loan is performing under the current contractual terms, income is recognized under the accrual method. For the year ended December 31, 2009, the Company recognized $326,000 in income on such loans. For the years ended December 31, 2008 and 2007, the Company recognized no income on such loans.

The largest category of impaired loans during the year ended December 31, 2009 has been real estate construction and development loans, with that loan category comprising almost 48% of total impaired loans at December 31, 2009. Impaired construction loans decreased $16.2 million, impaired commercial and industrial loans decreased $1.23 million, and impaired agricultural loans decreased $2.4 million during the fourth quarter of 2009. Although impaired balances for construction loans have declined slightly during the year ended December 31, 2009, and construction loans are generally collateral dependent and the related collateral is considered adequate to cover the loan’s carrying value in many cases, the specific reserve related to impaired construction loans has increased approximately $2.4 million since December 31, 2008 as property valuations have declined. Specific collateral related to impaired loans is reviewed for current appraisal information, economic trends within geographic markets, loan-to-value ratios, and other factors that may impact the value of the loan collateral. Adjustments are made to collateral values as needed for these factors. Of total impaired loans, approximately $39.7 million or 73.7% are secured by real estate. The following table summarizes the components of impaired loans and their related specific allowance at December 31, 2009, September 30, 2009 and December 31, 2008.

(in 000’s)	Balance December 31, 2009	Allowance December 31, 2009	Balance Sept 30, 2009	Allowance Sept 30, 2009	Balance December 31, 2008	Allowance December 31, 2008
Commercial and industrial	$ 9,064	$ 2,383	$ 10,260	$ 2,491	$ 12,244	$ 2,340
Real estate – mortgage	12,584	536	12,718	344	3,689	226
RE construction and development	25,606	4,741	41,801	3,751	28,927	2,338
Agricultural	6,212	153	8,651	934	4,086	68
Installment/other	328	160	332	167	0	0
Lease financing	0	0	0	0	0	0
Total	$ 53,794	$ 7,973	$ 73,761	$ 7,687	$ 48,946	$ 4,972

Geographically, the $53.8 million in impaired loans are disbursed throughout a wide area of California, with approximately 62.7% of those loans within Fresno, Madera, Kern, and Santa Clara Counties. The following table summarizes the impaired loan balances by county as of December 31, 2009.

County	Impaired Balance (000's)	Percentage
Kern	$ 21,686	40.31%
Fresno	9,954	18.50%
Monterey	7,514	13.97%
Merced	2,581	4.80%
Madera	3,602	6.70%
San Mateo	2,089	3.88%
Santa Clara	2,103	3.91%
Mariposa	1,850	3.44%
Tulare	1,160	2.16%
Marin	839	1.56%
Other counties	416	0.77%
Total impaired loans	$ 53,794	100.00%

The Company focuses on competition and other economic conditions within its market area and other geographical areas in which it does business, which may ultimately affect the risk assessment of the portfolio. The Company continues to experience increased competition from major banks, local independents and non-bank institutions creating pressure on loan pricing. With interest rates decreasing 100 basis points during the fourth quarter of 2007, another 400 basis points during 2008, indications are that the economy will continue to suffer in the near future as a result of sub-prime lending problems, a weakened real estate market, and tight credit markets. As a result of these conditions, the Company has placed increased emphasis on reducing both the level of nonperforming assets and the level of losses taken, if any, on the disposition of these assets if required It has been in the best interest of both the Company and the borrowers to seek alternative options to foreclosure in an effort to diminish the impact on an already depressed real estate market. As part of this strategy, the Company has increased its level of troubled debt restructurings, when it makes economic sense. Both business and consumer spending have slowed during the past several quarters, and current GDP projections for the next year have softened significantly. It is difficult to determine to what degree the Federal Reserve will adjust short-term interest rates in its efforts to influence the economy, or what magnitude government economic support programs will reach. It is likely that the business environment in California will continue to be influenced by these domestic as well as global events. The local market has remained relatively more stable economically during the past several years than other areas of the state and the nation, which have experienced more volatile economic trends, including significant deterioration of residential real estate markets. Although the local area residential housing markets have been hit hard, they continue to perform better than other parts of the state, which should bode well for sustained, but slower growth in the Company’s market areas of Fresno and Madera, Kern, and Santa Clara Counties. Local unemployment rates in the San Joaquin Valley remain high primarily as a result of the areas’ agricultural dynamics, however unemployment rates have increased recently as the national economy has declined. It is difficult to predict what impact this will have on the local economy. The Company believes that the Central San Joaquin Valley will continue to grow and diversify as property and housing costs remain reasonable relative to other areas of the state. Management recognizes increased risk of loss due to the Company's exposure from local and worldwide economic conditions, as well as potentially volatile real estate markets, and takes these factors into consideration when analyzing the adequacy of the allowance for credit losses.

The following table provides a summary of the Company's allowance for credit losses, provisions made to that allowance, and charge-off and recovery activity affecting the allowance for the years indicated.

			December 31,		
(Dollars in thousands)	2009	2008	2007	2006	2005
Total loans outstanding at end of period before deducting allowances for credit losses	$ 507,709	$ 543,317	$ 591,056	$ 488,680	$ 406,266
Average net loans outstanding during period	$ 534,830	$ 582,500	$ 575,448	$ 464,514	$ 397,375
Balance of allowance at beginning of period	$ 11,529	$ 7,431	$ 4,381	$ 4,295	$ 5,147
Loans charged off:					
Real estate	(4,245)	(3,103)	(4,005)	0	0
Commercial and industrial	(5,648)	(1,890)	(303)	(290)	(323)
Lease financing	(122)	(281)	(8)	(163)	(364)
Installment and other	(130)	(271)	(177)	(48)	(86)
Total loans charged off	(10,145)	(5,545)	(4,493)	(501)	(773)
Recoveries of loans previously charged off:					
Real estate	1	0	0	0	0
Commercial and industrial	245	92	46	195	108

Lease financing	1	14	0	1	3
Installment and other	10	11	18	43	54
Total loan recoveries	257	117	64	239	165
Net loans charged off	(9,888)	(5,428)	(4,429)	(262)	(608)
Reclassification of off-balance sheet reserve	0	0	0	0	(35)
Reserve acquired in business acquisition	0	0	1,268	0	0
Provision charged to operating expense	13,375	9,526	6,211	328	(209)
Balance of allowance for credit losses at end of period	$ 15,016	$ 11,529	$ 7,431	$ 4,361	$ 4,295
Net loan charge-offs to total average loans	1.85%	0.93%	0.77%	0.06%	0.15%
Net loan charge-offs to loans at end of period	1.95%	1.00%	0.75%	0.05%	0.15%
Allowance for credit losses to total loans at end of period	2.96%	2.12%	1.26%	0.89%	1.06%
Net loan charge-offs to allowance for credit losses	68.85%	47.08%	59.60%	6.01%	14.16%
Net loan charge-offs to provision for credit losses	73.93%	56.98%	71.31%	79.88%	-290.91%

Management believes that the 2.96% credit loss allowance to total loans at December 31, 2009 is adequate to absorb known and inherent risks in the loan portfolio. No assurance can be given, however, that the economic conditions which may adversely affect the Company's service areas or other circumstances will not be reflected in increased losses in the loan portfolio. Management is not currently aware of any conditions that may adversely affect the levels of losses incurred in the Company's loan portfolio.

Although the Company does not normally allocate the allowance for credit losses to specific loan categories, an allocation to the major categories has been made for the purposes of this report as set forth in the following table. The allocations are estimates based on the same factors as considered by management in determining the amount of additional provisions to the credit loss allowance and the overall adequacy of the allowance for credit losses.

	2009		2008		2007		2006		2005	
(Dollars in thousands)	Allowance for Credit Losses	% of Loans	Allowance for Credit Losses	% of Loans	Allowance For Credit Losses	% of Loans	Allowance for Credit Losses	% of Loans	Allowance for Credit Losses	% of Loans
Commercial and industrial	$ 7,125	33.0%	$ 4,620	34.6%	$ 3,008	31.9%	$ 1,821	29.7%	$ 1,397	27.1%
Real estate – mortgage	1,426	32.6%	787	24.0%	593	22.8%	619	22.9%	330	21.7%
RE construction and development	5,561	20.7%	4,796	27.7%	3,070	33.8%	1,123	35.7%	1,598	39.7%
Agricultural	334	10.0%	1,035	9.6%	559	7.8%	310	7.1%	316	6.0%
Installment/other	535	3.6%	101	3.8%	133	3.1%	187	3.4%	112	3.6%
Lease financing	35	0.1%	49	0.3%	68	0.6%	161	1.1%	166	1.7%
Not allocated	0	--	142	--	0	--	140	--	376	--
	$ 15,016	100.0%	$ 11,529	100.0%	$ 7,431	100.0%	$ 4,361	100.0%	$ 4,295	100.0%

During 2009, reserve allocations increased for commercial and industrial loans, real estate mortgage loans, construction loans, and installment loans. Increased reserve allocations for commercial and industrial loans are the result of increased loan volume and increased loss factors applied to classified loan classifications, while increases in reserve allocations for real estate mortgage and installment loans are primarily the result of increases in substandard loans in those categories. Reserve allocations increased for real estate construction loans as a result of both an increase in the level of special mention loans in that category, as well as increased specific reserves on certain loans in that category between December 31, 2008 and December 31, 2009.

During 2008, reserve allocations increased for commercial and industrial loans, as well as construction and agricultural loans. As with prior years, the significant reserve allocation for lease financing loans is the result of specific reserves allocated to a lease portfolio that has been nonperforming since 2002 and is in the process of litigation (see discussion following). Increased reserve allocations for commercial and industrial loans, construction loans, as well as agricultural loans, are the result of increases in special mention and substandard loans in those categories, with an increase in the volume of loans considered impaired. Successful re-margining of a number of the Company's problem loans during the third and fourth quarters of 2008 helped to reduce potential loss exposure in the loan portfolio.

During 2007, reserve allocations increased significantly for commercial and industrial loans, construction loans, and to lesser extent, agricultural loans. Increased reserve allocations for commercial and industrial loans, as well as agricultural loans are the result of increased loan volume, as well as increases in substandard loans in those categories. Increases in reserve allocations for construction loans are primarily the result of increases in special mention and substandard loans in those categories. Reserve allocations decreased for lease financing loans as a result of declining balances in the lease portfolio.

The Company purchased a schedule of payments collateralized by Surety Bonds and lease payments in September 2001 that have a current balance owing of $5.4 million plus interest. The leases have been nonperforming since June 2002 (see "Asset Quality and Allowance for Credit Losses" section of Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the Company's 2007 Annual Report on Form 10-K). For reporting purposes at December 31, 2008, the impaired lease portfolio was on non-accrual status and had a specific allowance allocation of $3.5 million, and a net carrying value of $1.9 million. During the first quarter of 2009, the Company evaluated its position with regard to the nonperforming lease portfolio, and determined that because the ultimate payoff of the lease portfolio would come from the underlying surety bonds rather than individual leases, the portfolio was better classified as a receivable to be included in other assets rather than classified as loans. As a result, the Company reclassified the net lease amount of $1.9 million ($5.4 million in gross leases less $3.5 million is specific reserve) from loans to other assets effective January 1, 2009. All periods presented in this 10-K for the period ended December 31, 2009 have been restated to reflect the transfer of the nonperforming lease portfolio from loans to other assets. During June 2009, the Company agreed to settle with the insurance company issuing the surety bonds for a total settlement amount of $2.0 million. At June 30, 2009, the Company increased the lease receivable classified in other assets to reflect the $2.0 million settlement amount, and recorded a gain of $117,000 for the difference between the carrying amount previously recorded and the settlement amount. The Company received the proceeds from the settlement during July 2009.

The following summarizes the Company's allowance for credit losses related to the specific, formula, and unallocated reserves for the year-ends shown:

	December 31,				
(Dollars in 000's)	2009	2008	2007	2006	2005
Formula allowance	$ 7,043	$ 6,414	$ 6,447	$ 3,637	$ 2,976
Specific allowance	7,973	4,973	984	584	943
Unallocated allowance	0	142	0	140	376
Total allowance	$ 15,016	$ 11,529	$ 7,431	$ 4,361	$ 4,295

At December 31, 2009, the allowance for credit losses totaled $15.0 million, and consisted of $7.0 million in formula allowance, $8.0 million in specific allowance, and no unallocated allowance. At December 31, 2009, $4.7 million of the specific allowance was allocated to real estate construction loans, and the remaining $2.4 million, $536,000, $160,000, and $153,000 were allocated to commercial and industrial loans, commercial real estate, installment loans, and agricultural loans, respectively.

The allowance for credit losses totaled $11.5 million At December 31, 2008, and consisted of $6.4 million in formula allowance, $5.0 million in specific allowance, and $142,000 in unallocated reserve. At December 31, 2008, $2.3 million of the specific allowance was allocated to real estate construction loans, and the remaining $2.3 million, $227,000, and $68,000 were allocated to commercial and industrial loans, real estate commercial loans, and agricultural loans, respectively.

At December 31, 2007, the allowance for credit losses totaled $7.4 million, and consisted of $6.4 million in formula allowance, and $984,000 in specific allowance. At December 31, 2007, $599,000 of the specific allowance was allocated to real estate construction loans, and the remaining $339,000 and $46,000 were allocated to commercial and industrial loans, and leases, respectively.

The total formula allowance increased approximately $629,000 between 2008 and 2009, primarily as the result of increased loss factors applied to "pass loans" which more than outweighed the decline in volume of "pass" loans. Between December 31, 2008 and December 31, 2009, sub-substandard loans decreased $14.5 million, while special mention loans decreased $5.9 million, but the specific reserve increased $3.0 million during the period as a result of deterioration in the impaired loan portfolio.

The total formula allowance decreased approximately $33,000 between 2007 and 2008, primarily as the result of decreased volume in “pass” loans. The formula allowance for construction loans decreased $905,000 during 2008, but increased $574,000 and $408,000 for commercial real estate loans and agricultural loans, respectively, with only minor changes in other loan categories. Between December 31, 2007 and December 31, 2008, sub-substandard loans increased $34.8 million, while special mention and doubtful loans increased $21.1 million and $1.6 million, respectively. Increases in loan downgrades experienced during 2008 were primarily the result of continued deterioration in the overall economy, including the residential construction market, which in turn has impacted other sectors of the lending portfolio.

The total formula allowance increased approximately $2.8 million between 2006 and 2007, primarily as the result of increased volume in “pass” loans. There were only minor formula allowance allocation changes between loan categories occurring between December 31, 2006 and December 31, 2007, and so most changes in the formula allowance during 2007 were the result of volume changes.

Between December 31, 2006 and December 31, 2007, substandard loans increased $35.0 million, while special mention and doubtful loans increased $8.6 million and $891,000 million, respectively. Increases in loan downgrades experienced during 2007 were primarily the result of deteriorating economic factors in the residential construction market, which in turn has impacted other sectors of the lending portfolio.

Although in some instances, the downgrading of a loan resulting from the factors used by the Company in its allowance analysis has been reflected in the formula allowance, management believes that in some instances, the impact of material events and trends has not yet been reflected in the level of nonperforming loans or the internal risk grading process regarding these loans. Accordingly, the Company’s evaluation of probable losses related to these factors may be reflected in the unallocated allowance. The evaluation of the inherent losses concerning these factors involve a higher degree of uncertainty because they are not identified with specific problem credits, and therefore the Company does not spread the unallocated allowance among segments of the portfolio. At December 31, 2009 and December 31, 2007, the Company had no unallocated allowance, while at December 31, 2008 the Company had an unallocated allowance of $142,000. Management’s estimates of the unallocated allowance are based upon a number of underlying factors including 1) the effect of deteriorating national and local economic trends, 2) the effects of export market conditions on certain agricultural and manufacturing borrowers, 3) the effects of abnormal weather patterns on agricultural borrowers, as well as other borrowers that may be impacted by such conditions, 4) the effect of increased competition in the Company’s market area and the resultant potential impact of more relaxed underwriting standards to borrowers with multi-bank relationships, 5) the effect of soft real estate markets, and 6) the effects of having a larger number of borrowing relationships which are close to the Company’s lending limit, any one if which were not to perform to contractual terms, would have a material impact on the allowance.

The Company's loan portfolio has concentrations in commercial real estate, commercial, and construction loans, however the portfolio percentages fall within the Company's loan policy guidelines.

It is the Company's policy to discontinue the accrual of interest income on loans for which reasonable doubt exists with respect to the timely collectibility of interest or principal due to the inability of the borrower to comply with the terms of the loan agreement. Such loans are placed on nonaccrual status whenever the payment of principal or interest is 90 days past due or earlier when the conditions warrant, and interest collected is thereafter credited to principal to the extent necessary to eliminate doubt as to the collectibility of the net carrying amount of the loan. Management may grant exceptions to this policy if the loans are well secured and in the process of collection.

The following table sets forth the Company’s nonperforming assets as of the dates indicated:

			December 31,		
(Dollars in thousands, except footnote)	2009	2008	2007	2006	2005
Nonaccrual loans (1)	$ 34,757	$ 45,671	$ 16,158	$ 2,693	$ 8,485
Restructured loans	16,026	0	23	4,906	0
Total non-performing loans	50,783	45,671	16,181	7,599	8,485
Other real estate owned	36,217	30,153	6,666	1,919	4,356
Total non-performing assets	$ 87,000	$ 75,824	$ 22,847	$ 9,518	$ 12,841
Loans, past due 90 days or more, still accruing	$ 486	$ 680	$ 189	$ 0	$ 0
Non-performing loans to total gross loans	9.99%	8.39%	2.73%	1.53%	2.06%
Non-performing assets to total gross loans	17.11%	13.92%	3.85%	1.92%	3.11%

(1)

Included in nonaccrual loans at December 31, 2009 and 2008 are restructured loans totaling $10.0 million and $378,000, respectively. There were no nonaccrual loans at December 31, 2007 which are restructured. The interest income that would have been earned on nonaccrual loans outstanding at December 31, 2009 in accordance with their original terms is approximately $3.2 million.

Non-performing assets have increased between December 31, 2008 and December 31, 2009 as the prolonged economic downturn continued into 2009. While nonaccrual loans decreased $10.9 million between December 31, 2008 and December 31, 2009, restructured loans not included in the nonaccrual totals increased $16.0 million as the Company sought to work-out problem credits with borrowers. When all other means of repayment failed, the underlying collateral on nonperforming loans was foreclosed upon, resulting in the net increase of $6.1 million in other real estate owned between December 31, 2008 and December 31, 2009. The net change in other real estate owned includes additions of approximately $20.0 million in properties transferred from loans, and gross sales of nearly $13.6 million during the year ended December 31, 2009.

Non-performing assets increased between December 31, 2007 and December 31, 2008 as declines in real estate markets and related sectors experienced since the later part of 2007 resulting from lending problems continued to impact credit markets and the general economy throughout 2008. Nonaccrual loans increased $29.5 million between December 31, 2007 and December 31, 2008, with construction loans comprising approximately 57% of total nonaccrual loans at December 31, 2008, and commercial and industrial loans comprising another 19%.

Non-performing assets increased between December 31, 2006 and December 2007 as housing markets and related sectors experienced declines during the second half of the year as a result of sub-prime lending problems which impacted credit markets and the overall economy worldwide. Economic conditions in the San Joaquin Valley remained strong during much of 2007, although as a result of the decline in the housing sector and related real estate valuations, nonperforming assets increased during the years and additional charge-offs were taken during the third and fourth quarters of 2007. Non-performing assets increased during 2007, totaling 4.73% of total loans at December 31, 2007 as compared to 2.99% of total loans at December 31, 2006. Non-performing loans, a component of non-performing assets, increased nearly $8.6 million during 2007 primarily as the result of real estate construction and real estate development loans which become impaired during the period. Some, but not all, of these nonperforming real estate credits were outside the Company's immediate market area, specifically Southern California and the San Francisco Bay area.

The following table summarizes the nonaccrual totals by loan category for the periods shown:

Nonaccrual Loans (in 000's):	Balance December 31, 2009	Balance Sept 30, 2009	Balance December 31, 2008	Change from Sept 30, 2009	Change from December 31, 2008
Commercial and industrial	$ 5,355	$ 6,531	$ 9,507	$ (1,176)	$ (4,152)
Real estate - mortgage	5,336	6,311	3,714	(975)	1,622
Real estate - construction	17,591	33,354	28,928	(15,763)	(11,337)
Agricultural	6,212	8,651	3,406	(2,439)	2,806
Installment/other	150	260	55	(110)	95
Lease financing	114	70	61	44	53
Total Nonaccrual Loans	$ 34,757	$ 55,177	$ 45,671	$ (20,420)	$ (10,914)

The decrease in nonaccrual real estate construction loans between December 31, 2008 and December 31, 2009 is partially the result of a single condominium project totaling $8.0 million at December 31, 2008, which was completed and sold during the fourth quarter of 2009. Decreases of $20.4 million in total nonaccrual loans between December 31, 2008 and December 31, 2009 included transfers of nearly $20.0 million to other real estate owned, as well as a number paydowns or payoffs on those nonperforming loans. Of the $20.0 million in transfers between nonaccrual loans and other real estate owned during 2009, $4.7 million was transferred during the fourth quarter of 2009.

Increases in nonaccrual construction loans between December 31, 2007 and December 31, 2008 are the result of a significant slowdown in new housing starts and the resultant depreciation in land, and both partially completed and completed construction projects. Nonaccrual construction loans decreased $10.2 million during the fourth quarter of 2008, primarily as the result of construction loans that were transferred to other real estate owned. As with impaired loans, a large percentage of nonaccrual loans were made for the purpose of residential construction, residential and commercial acquisition and development, and land development. The following table summarizes nonaccrual balances by purpose at both December 31, 2009 and December 31, 2008.

(000's)	December 31, 2009	December 31, 2008

Residential construction	$	6,847	$	17,386
Residential and commercial acquisition and development		11,176		450
Land development		2,524		16,043
Other purposes		14,210		11,792
Total nonaccrual loans	$	34,757	$	45,671

Loans past due more than 30 days are receiving increased management attention and are monitored for increased risk. The Company continues to move past due loans to nonaccrual status in its ongoing effort to recognize loan problems at an earlier point in time when they may be dealt with more effectively. As impaired loans, nonaccrual and restructured loans are reviewed for specific reserve allocations and the allowance for credit losses is adjusted accordingly.

Except for the loans included in the above table, and the land development loan discussed above, there were no loans at December 31, 2009 where the known credit problems of a borrower caused the Company to have serious doubts as to the ability of such borrower to comply with the present loan repayment terms and which would result in such loan being included as a nonaccrual, past due or restructured loan at some future date.

Liquidity and Asset/Liability Management

The primary function of asset/liability management is to provide adequate liquidity and maintain an appropriate balance between interest-sensitive assets and interest-sensitive liabilities.

Liquidity

Liquidity management may be described as the ability to maintain sufficient cash flows to fulfill both on- and off-balance sheet financial obligations, including loan funding commitments and customer deposit withdrawals, without straining the Company's equity structure. To maintain an adequate liquidity position, the Company relies on, in addition to cash and cash equivalents, cash inflows from deposits and short-term borrowings, repayments of principal on loans and investments, and interest income received. The Company's principal cash outflows are for loan origination, purchases of investment securities, depositor withdrawals and payment of operating expenses. Other sources of liquidity not on the balance sheet at December 31, 2009 include unused collateralized and uncollateralized lines of credit from other banks, the Federal Home Loan Bank, and from the Federal Reserve Bank totaling $165.0 million.

Cash and cash equivalents have fluctuated during the three years ended December 31, 2009, 2008, and 2007, with period-end balances as follows (from Consolidated Statements of Cash Flows – in 000's):

	Balance
December 31, 2009	$ 29,229
December 31, 2008	$ 19,426
December 31, 2007	$ 25,300
December 31, 2006	$ 43,068

Cash and cash equivalents increased $9.8 million during the year ended December 31, 2009, as compared to a decrease of $5.9 million and $17.8 million during the years ended December 31, 2008 and 2007, respectively.

The Company has maintained positive cash flows from operations over the past three years, which amounted to $13.3 million, $12.6 million, and $19.0 million for the years ended December 31, 2009, 2008, and 2007, respectively.

The Company experienced net cash inflows from investing activities totaling $58.3 million during the year ended December 31, 2009, as the Company experienced maturities of investment securities and interest-bearing deposits with other banks, as well as net decreases in loans. The Company experienced net cash outflows from investing activities totaling $9.4 million during the year ended December 31, 2008, as purchases of investment securities interest-bearing deposits in other banks exceeded net loan payoffs and maturities of investment securities during the period. The Company experienced net cash outflows from investing activities totaling $30.5 million during the year ended December 31, 2007 as loan growth has exceeded net maturities of investment securities as well as other investment instruments during the year.

Net cash flows from financing activities, including deposit growth and borrowings, have traditionally provided funding sources for loan growth, but during 2009, 2008, and 2007 the Company experienced net cash outflows totaling $61.8 million, $9.1 million, and $6.3 million, respectively. The cash outflows experienced during 2009 were primarily the result of planned reductions in outstand borrowings which exceeded increases in deposit accounts.

During 2008 and 2007 declines in net deposit accounts, as well as repurchases of the Company's common stock, exceeded growth in financing categories, including borrowings. The Company has the ability to decrease loan growth, increase deposits and borrowings, or a combination of both to manage balance sheet liquidity.

Liquidity risk arises from the possibility the Company may not be able to satisfy current or future financial commitments, or the Company may become unduly reliant on alternative funding sources. The Company maintains a liquidity risk management policy to address and manage this risk. The policy identifies the primary sources of liquidity, sets wholesale funding limits, establishes procedures for monitoring and measuring liquidity, and establishes minimum liquidity requirements, which comply with regulatory guidance. The liquidity position is continually monitored and reported on a monthly basis to the Board of Directors.

The policy also includes a contingency funding plan to address liquidity needs in the event of an institution-specific or a systemic financial market crisis. In addition to unused lines of credit from other banks totaling $125.0 million, the contingency plan includes identified funding sources, and steps that may be taken in the event the total liquidity ratio falls or is projected to fall below policy limits for any extended period of time. One of the primary directives of the contingency funding plan is to limit the Company’s overall level of wholesale funding to no more than 40% of deposits. The current funding program uses both asset-based and liability-based principles, and identifies core deposits as the favored funding source when attainable at a reasonable cost. The policy identifies a number of funding sources or methods the Bank ALCO committee may utilize to fulfill the Company’s liquidity funding requirements:

1) Local core deposits are the Company’s primary funding source. The Company must expand its efforts to attract these deposits through service-related and competitive pricing tactics. Other liquidity funding sources should only be consider of local core deposits are not attractive because of maturity or pricing.

2) Unsecured Federal Funds lines with correspondent banks may be used to fund short-term peaks in loan demand or deposit run-off. Currently, unsecured borrowing lines with correspondents are limited and may not be reliable for long periods of time or in times of economic stress.

3) Other funding sources such as secured credit lines with the Federal Home Loan Bank or the Federal Reserve may be used for longer periods. The Company collateralizes these available lines with a combination of investment securities and pledged loans. The Company has utilized specific loan pledging with both the FHLB and the Federal Reserve to better ensure the continued availability of those lines of credit.

4) The Company presently has a Discount Window facility available from the Federal Reserve Bank of San Francisco collateralized with loans as discussed above. At December 31, 2009 the Company had available credit of $120.7 million from the Federal Reserve based upon the loans pledged at that date. The Federal Reserve will monitor use of the Discount Window closely given the current status of the Company and the economy as a whole and. In addition, this credit facility may not be competitively priced under normal economic conditions. As such, the Company does not expect to use this facility except in times of crises, but does consider this to be a key contingency funding source.

5) As long as the Bank remains “Well Capitalized” the Company may rely on brokered deposits when core deposit rates are higher in the marketplace or maturity structures are not desirable. The Company’s current policy limit for brokered deposits is 25% of total deposits. The Company may also utilize other wholesale deposit sources such as memberships that advertise the Bank’s time deposit rates to other subscribers, typically banks and credit unions. The Company’s current policy limit on other wholesale deposits is 10% of total deposits.

6) The Bank may sell whole loans or participations in loans to provide additional liquidity. During economic downturns or other crises events, these funding sources may be difficult to achieve in a short period of time or at a reasonable price. As such, this strategy is better used as a long-term asset/liability management tool to effectively balance assets and liabilities to reduce liquidity risk.

7) The Company currently has Bank Owned Life Insurance (BOLI) policies issued by highly rated insurance companies which may be sold to increase liquidity.

8) The Company owns certain real estate including its administration building and several of its branches. These may be sold and vacated or leased back from the purchaser after sale to provide additional liquidity if needed. The sales process may require substantial time to complete, and may have an adverse impact on earnings depending on market rates and other factors at the time of sale.

9)

Investments near maturity may be sold to meet temporary funding needs but may need to be replaced to maintain liquidity ratios within acceptable limits. At the current time much of the investment portfolio is pledged to secure public deposits and borrowing lines. As wholesale funding dependence is reduced, the available liquidity in the investment portfolio will increase. The Company seeks to maintain an investment-grade securities portfolio to ensure quality collateral for pledging against borrowing lines of credit as well as to provide liquidity in times of needs.

The Company continues to utilize liability management, when needed, as part of its overall asset/liability management strategy. Through the discretionary acquisition of short term borrowings, the Company has been able to provide liquidity to fund asset growth while, at the same time, better utilizing its capital resources, and better controlling interest rate risk. The borrowings are generally short-term and more closely match the repricing characteristics of floating rate loans, which comprise approximately 60.7% of the Company's loan portfolio at December 31, 2009. This does not preclude the Company from selling assets such as investment securities to fund liquidity needs but, with favorable borrowing rates, the Company has maintained a positive yield spread between borrowed liabilities and the assets which those liabilities fund. If, at some time, rate spreads become unfavorable, the Company has the ability to utilize an asset management approach and, either control asset growth or, fund further growth with maturities or sales of investment securities.

The Company's liquid asset base which generally consists of cash and due from banks, federal funds sold, securities purchased under agreements to resell ("reverse repos") and investment securities, is maintained at a level deemed sufficient to provide the cash outlay necessary to fund loan growth as well as any customer deposit runoff that may occur. Within this framework is the objective of maximizing the yield on earning assets. This is generally achieved by maintaining a high percentage of earning assets in loans, which historically have represented the Company's highest yielding asset. At December 31, 2009, the Bank had 71.1% of total assets in the loan portfolio and a loan-to-deposit ratio of 90.4%. Liquid assets at December 31, 2009 include cash and cash equivalents totaling $29.2 million as compared to $19.4 million at December 31, 2008.

Liabilities used to fund liquidity sources include core and non-core deposits as well as short-term borrowings. Core deposits, which comprise approximately 66.7% of total deposits at December 31, 2009, provide a significant and stable funding source for the Company. At December 31, 2009, unused lines of credit with the Federal Home Loan Bank and the Federal Reserve Bank totaling $125.0 million are collateralized in part by certain qualifying loans in the Company's loan portfolio. The carrying value of loans pledged on these used and unused borrowing lines totaled $270.9 million at December 31, 2009. For further discussion of the Company's borrowing lines, see "Short Term Borrowings" included in previously in the financial condition section of this financial review. The Federal Reserve Board has notified the Bank that it will permit the Bank to draw on its line of credit with the Federal Reserve Bank only in limited circumstances and for a short duration.

The liquidity of the parent company, United Security Bancshares, is primarily dependent on the payment of cash dividends by its subsidiary, United Security Bank, subject to limitations imposed by the Financial Code of the State of California. The Bank currently has limited ability to pay dividends or make capital distributions (see Regulatory Agreement section included in Regulatory Matters of this Management's Discussion.) The limited ability of the Bank to pay dividends may impact the ability of the Company to fund its ongoing liquidity requirements including ongoing operating expenses, as well as quarterly interest payments on the Company's junior subordinated debt (Trust Preferred Securities.) Under an agreement with the Federal Reserve dated March 23, 2010, the Bank is precluded from paying a cash dividend to the Company. To conserve cash and capital resources, the Company elected at September 30, 2009 to defer the payment of interest on its junior subordinated debt beginning with the quarterly payment due October 1, 2009. The Company has not determined how long it will defer interest payments, but under the terms of the debenture, interest payments may be deferred up to five years (20 quarters). During such deferral periods, the Company is prohibited from paying dividends on its common stock (subject to certain exceptions) and will continue to accrue interest payable on the junior subordinated debt. During the year ended December 31, 2009, cash dividends paid by the Bank to the parent company totaled $200,000.

Contractual Obligations, Commitments, Contingent Liabilities, and Off-Balance Sheet Arrangements

The following table presents, as of December 31, 2009, the Company's significant fixed and determinable contractual obligations by payment date. The payment amounts represent those amounts contractually due to the recipient and do not include any unamortized premiums or discounts, or other similar carrying value adjustments. Further discussion of the nature of each obligation is included in the referenced note to the consolidated financial statements.

		Payments Due In				
(In thousands)	Note Reference	One Year Or Less	One to Three Years	Three to Five Years	Over Five Years	Total
Deposits without a stated maturity	6	$ 332,665	$ ----	$ ----	$ ----	$ 332,665
Time Deposits	6	218,694	9,386	904	11	228,995
FHLB Borrowings	7	40,000				40,000
Junior Subordinated Debt (at FV)	8				10,716	10,716
Operating Leases	12	713	781	743	661	2,898
Contingent tax liabilities	9	1,560				1,560

A schedule of significant commitments at December 31, 2009 follows:

(In thousands)		
Commitments to extend credit:		
Commercial and industrial	$	45,865
Real estate – mortgage		4,502
Real estate – construction		19,691
Agricultural		10,319
Installment		3,377
Revolving home equity and credit card lines		263
Standby letters of credit		3,975

Further discussion of these commitments is included in Notes 3 and 12 to the consolidated financial statements.

Regulatory Matters

Regulatory Agreement

Effective March 23, 2010, United Security Bancshares (the "Company") and its wholly owned subsidiary, United Security Bank (the "Bank"), entered into a written agreement with the Federal Reserve Bank of San Francisco. Under the terms of the agreement, the Company and the Bank agreed, among other things, to strengthen board oversight of management and the Bank's operations; submit an enhanced written plan to strengthen credit risk management practices and improve the Bank's position on the past due loans, classified loans, and other real estate owned; maintain a sound process for determining, documenting, and recording an adequate allowance for loan and lease losses; improve the management of the Bank's liquidity position and funds management policies; maintain sufficient capital at the Company and Bank level; and improve the Bank's earnings and overall condition. The Company and Bank have also agreed not to increase or guarantee any debt, purchase or redeem any shares of stock, declare or pay any cash dividends, or pay interest on the Company's junior subordinated debt or trust preferred securities, without prior written approval from the Federal Reserve Bank.

This agreement was a result of a regulatory examination that was conducted by the Federal Reserve and the California Department of Financial Institutions in June 2009, and relates primarily to the Bank's asset quality. Progress on these items has been made since the completion of the examination and management and the Board are committed to resolving all of the items addressed by the Federal Reserve in the agreement. Both the Company and the Bank will submit quarterly written progress reports to the Federal Reserve Bank.

The Company and the Bank have also received notification from the California Department of Financial Institutions of their intention to issue a regulatory order as a result of the June 2009 regulatory examination. The Company and the Bank have not yet entered into an agreement with the California Department of Financial Institutions, but believe that any agreement entered into, will be similar to the current agreement with the Federal Reserve Bank of San Francisco.

Capital Adequacy

Capital adequacy for bank holding companies and their subsidiary banks has become increasingly important in recent years. Continued deregulation of the banking industry since the 1980's has resulted in, among other things, a broadening of business activities allowed beyond that of traditional banking products and services. Because of this volatility within the banking and financial services industry, regulatory agencies have increased their focus upon ensuring that banking institutions meet certain capital requirements as a means of protecting depositors and investors against such volatility.

During July 2007, the Company redeemed its $15.0 million in Trust Preferred Securities originally issued during 2001 under United Security Bancshares Capital Trust I. During the same month, the Company issued $15.0 million in new Trust Preferred Securities with similar terms under newly formed United Security Bancshares Capital Trust II. Under applicable regulatory guidelines, the Trust Preferred Securities qualify as Tier 1 capital up to a maximum of 25% of Tier 1 capital. Any additional portion will qualify as Tier 2 capital. As shareholders' equity increases, the amount of Tier 1 capital that can be comprised of Trust Preferred Securities will increase.

The Board of Governors of the Federal Reserve System ("Board of Governors") has adopted regulations requiring insured institutions to maintain a minimum leverage ratio of Tier 1 capital (the sum of common stockholders' equity, noncumulative perpetual preferred stock and minority interests in consolidated subsidiaries, minus intangible assets, identified losses and investments in certain subsidiaries, plus unrealized losses or minus unrealized gains on available for sale securities) to total assets. Institutions which have received the highest composite regulatory rating and which are not experiencing or anticipating significant growth are required to maintain a minimum leverage capital ratio of 3% Tier 1 capital to total assets. To be considered well capitalized, the institution must maintain a leverage capital ratio of 5%. All other institutions are required to maintain a minimum leverage capital ratio of at least 100 to 200 basis points above the minimum requirements.

The Board of Governors has also adopted a statement of policy, supplementing its leverage capital ratio requirements, which provides definitions of qualifying total capital (consisting of Tier 1 capital and Tier 2 supplementary capital, including the allowance for loan losses up to a maximum of 1.25% of risk-weighted assets) and sets forth minimum risk-based capital ratios of capital to risk-weighted assets. The most highly rated insured institutions are required to maintain a minimum ratio of qualifying total capital to risk weighted assets of 8%, at least one-half (4%) of which must be in the form of Tier 1 capital. To be considered well capitalized, institutions must maintain a ratio of qualifying total capital to risk weighted assets of 10%, at least one-half (6%) of which must be in the form of Tier 1 capital.

The Bank has agreed with the California Department of Financial Institutions, to maintain Tier I capital and leverage ratios that are at or in excess of 9.00%. In addition, the Bank has agreed to maintain total risk-based capital ratios at or in excess of 10.00% (at or above "Well Capitalized" levels as defined.) The Company is not subject to "Well Capitalized" guidelines under regulatory Prompt Corrective Action Provisions.

The following table sets forth the Company's and the Bank's actual capital positions at December 31, 2009 and the regulatory minimums for the Company and the Bank to be well capitalized under the guidelines discussed above:

	Company Actual Capital Ratios	Bank Actual Capital Ratios	Minimum Capital Ratios	Regulatory Minimums - Well Capitalized
Total risk-based capital ratio	14.30%	13.70%	10.00%	10.00%
Tier 1 capital to risk-weighted assets	13.03%	12.47%	9.00%	6.00%
Leverage ratio	11.68%	11.19%	9.00%	5.00%

As is indicated by the above table, the Company and the Bank exceeded all applicable regulatory capital guidelines at December 31, 2009. Management believes that, under the current regulations, both will continue to meet their minimum capital requirements in the foreseeable future.

Dividends

Dividends paid to shareholders by the Company are subject to restrictions set forth in the California General Corporation Law. The California General Corporation Law provides that a corporation may make a distribution to its shareholders if retained earnings immediately prior to the dividend payout are at least equal the amount of the proposed distribution. The primary source of funds with which dividends will be paid to shareholders will come from cash dividends received by the Company from the Bank. As noted earlier, the Company and the Bank have entered into an agreement with the Federal Reserve Bank that, among other things, require us to obtain the prior approval before paying a cash dividend or otherwise making a distribution on our stock. In addition, the Company has elected to defer regularly scheduled quarterly interest payments on its junior subordinated debentures issued in connection with its trust preferred securities. The Company is prohibited from paying any dividends or making any other distribution on its common stock for so long as interest payments are being deferred. During the year ended December 31, 2009, the Company received $200,000 in cash dividends from the Bank. During the same period, the Company paid $6,000 in cash dividends to shareholders representing cash-in-lieu amounts paid in connection quarterly stock dividends.

The Bank as a state-chartered bank is subject to dividend restrictions set forth in California state banking law, and administered by the California Commissioner of Financial Institutions ("Commissioner"). Under such restrictions, the Bank may not pay cash dividends in an amount which exceeds the lesser of the retained earnings of the Bank or the Bank's net income for the last three fiscal years (less the amount of distributions to shareholders during that period of time). If the above test is not met, cash dividends may only be paid with the prior approval of the Commissioner, in an amount not exceeding the Bank's net income for its last fiscal year or the amount of its net income for the current fiscal year. Such restrictions do not apply to stock dividends, which generally require neither the satisfaction of any tests nor the approval of the Commissioner. Notwithstanding the foregoing, if the Commissioner finds that the shareholders' equity is not adequate or that the declarations of a dividend would be unsafe or unsound, the Commissioner may order the state bank not to pay any dividend. The FRB may also limit dividends paid by the Bank. As noted above, the terms of the regulatory agreement with the Federal Reserve prohibit both the Company and the Bank from paying dividends without prior approval of the Federal Reserve.

Stock Repurchase Plan (all figures have been restated t reflect effect of 2-for-1 stock split during May 2006)

	For the Quarters Ended				
	March 31,	June 30,	September 30,	December 31,	YTD
Shares repurchased – 2009	488	0	0	0	488
Average price paid – 2009	$ 7.50	$ --	$ --	$ --	$ 7.50