

CENTRAL VALLEY COMMUNITY BANCORP

Form 10-Q

November 13, 2008

[Table of Contents](#)

## UNITED STATES

## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

### FORM 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2008**
- 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 31977

## CENTRAL VALLEY COMMUNITY BANCORP

(Exact name of registrant as specified in its charter)

**California**

(State or other jurisdiction of incorporation or organization)

**77-0539125**

(I.R.S. Employer Identification No.)

**7100 N. Financial Dr. Fresno, California**

(Address of principal executive offices)

**93720**

(Zip code)

Registrant's telephone number (559) 298-1775

Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

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 past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant 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

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes  No

As of November 12, 2008 there were 6,019,319 shares of the registrant's common stock outstanding

---

Table of Contents

**CENTRAL VALLEY COMMUNITY BANCORP**

**2008 QUARTERLY REPORT ON FORM 10-Q**

**TABLE OF CONTENTS**

<b><u>PART 1: FINANCIAL INFORMATION</u></b>	<b>3</b>
<b><u>ITEM 1: FINANCIAL STATEMENTS</u></b>	<b>3</b>
<b><u>ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u></b>	<b>13</b>
<b><u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u></b>	<b>32</b>
<b><u>ITEM 4. CONTROLS AND PROCEDURES</u></b>	<b>33</b>
<b><u>PART II OTHER INFORMATION</u></b>	<b>33</b>
<b><u>ITEM 1 LEGAL PROCEEDINGS</u></b>	<b>33</b>
<b><u>ITEM 1A RISK FACTORS</u></b>	<b>33</b>
<b><u>ITEM 2 CHANGES IN SECURITIES AND USE OF PROCEEDS</u></b>	<b>34</b>
<b><u>ITEM 3 DEFAULTS UPON SENIOR SECURITIES</u></b>	<b>34</b>
<b><u>ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u></b>	<b>34</b>
<b><u>ITEM 5 OTHER INFORMATION</u></b>	<b>34</b>
<b><u>ITEM 6 EXHIBITS</u></b>	<b>34</b>
<b><u>SIGNATURES</u></b>	<b>35</b>

Table of Contents

**PART 1: FINANCIAL INFORMATION**

**ITEM 1: FINANCIAL STATEMENTS**



**CENTRAL VALLEY COMMUNITY BANCORP**

## CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except share amounts)	September 30, 2008		December 31, 2007	
<b>ASSETS</b>				
Cash and due from banks	\$	19,461	\$	17,108
Federal funds sold		23,759		14,536
Total cash and cash equivalents		43,220		31,644
Securities:				
Available-for-sale investment securities (Amortized cost of \$94,388 at September 30, 2008 and \$84,139 at December 31, 2007)		90,533		84,373
Held-to-maturity, at amortized cost		7,453		
Loans, less allowance for credit losses of \$4,533 at September 30, 2008 and \$3,887 at December 31, 2007		349,345		337,241
Bank premises and equipment, net		5,940		5,767
Bank owned life insurance		6,911		6,723
Federal Home Loan Bank stock		2,110		2,022
Goodwill		8,934		8,934
Accrued interest receivable, intangibles and other assets		10,190		6,981
Total assets	\$	524,636	\$	483,685
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>				
Deposits:				
Non-interest bearing	\$	126,063	\$	128,120
Interest bearing		296,123		274,442
Total deposits		422,186		402,562
Short-term borrowings		19,900		20,000
Long-term debt		19,000		
Accrued interest payable and other liabilities		8,444		6,929
Total liabilities		469,530		429,491
Commitments and contingencies				
Shareholders' equity:				
Preferred stock, no par value; 10,000,000 shares authorized, no shares issued or outstanding				
Common stock, no par value; 80,000,000 authorized; outstanding 6,019,319 at September 30, 2008, 5,975,316 at December 31, 2007		14,016		13,571
Retained earnings		43,403		40,483
Accumulated other comprehensive (loss) income, net of tax		(2,313)		140
Total shareholders' equity		55,106		54,194
Total liabilities and shareholders' equity	\$	524,636	\$	483,685

See notes to unaudited condensed consolidated financial statements.

Table of Contents**CENTRAL VALLEY COMMUNITY BANCORP****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

(In thousands except earnings per share amounts)	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2008	2007	2008	2007
<b>INTEREST INCOME:</b>				
Interest and fees on loans	\$ 6,165	\$ 7,155	\$ 18,851	\$ 20,733
Interest on Federal funds sold	78	109	206	408
Interest and dividends on investment securities:				
Taxable	1,209	805	3,126	2,575
Exempt from Federal income taxes	224	212	681	662
Total interest income	7,676	8,281	22,864	24,378
<b>INTEREST EXPENSE:</b>				
Interest on deposits	1,388	2,065	4,580	5,951
Other	265	30	686	143
Total interest expense	1,653	2,095	5,266	6,094
Net interest income before provision for credit losses	6,023	6,186	17,598	18,284
<b>PROVISION FOR CREDIT LOSSES</b>	635	120	905	360
Net interest income after provision for credit losses	5,388	6,066	16,693	17,924
<b>NON-INTEREST INCOME:</b>				
Service charges	827	707	2,473	2,064
Appreciation in cash surrender value of bank owned life insurance	64	57	188	168
Loan placement fees	19	33	74	161
Net realized gains on sales and calls of investment securities	156		156	44
Federal Home Loan Bank stock dividends	32	25	88	76
Gain on sale and disposal of equipment				4
Other income	284	253	915	833
Total non-interest income	1,382	1,075	3,894	3,350
<b>NON-INTEREST EXPENSES:</b>				
Salaries and employee benefits	2,775	2,731	8,491	8,103
Occupancy and equipment	713	675	2,023	1,982
Other expense	1,496	1,458	4,408	4,240
Total non-interest expenses	4,984	4,864	14,922	14,325
Income before provision for income taxes	1,786	2,277	5,665	6,949
<b>PROVISION FOR INCOME TAXES</b>	572	701	1,831	2,302
Net income	\$ 1,214	\$ 1,576	\$ 3,834	\$ 4,647
Basic earnings per share	\$ 0.20	\$ 0.26	\$ 0.64	\$ 0.78
Diluted earnings per share	\$ 0.19	\$ 0.25	\$ 0.61	\$ 0.73
Cash dividends per share	\$	\$	\$ 0.10	\$

See notes to unaudited condensed consolidated financial statements.



Table of Contents

**CENTRAL VALLEY COMMUNITY BANCORP**

**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY**

**FOR THE YEAR ENDED DECEMBER 31, 2007**

**AND THE NINE MONTH PERIOD ENDED SEPTEMBER 30, 2008**

**(Unaudited)**

(In thousands except share and per share amounts)	Shares	Amount	Retained Earnings	Accumulated Other Comprehensive (Loss)/ Income (Net of Taxes)	Total Shareholders Equity	Total Comprehensive Income
Balance, January 1, 2007	6,037,656	\$ 14,007	\$ 35,888	\$ (117)	\$ 49,778	
Comprehensive income:						
Net income			6,280		6,280	\$ 6,280
Other comprehensive loss, net of tax:						
Net change in unrealized gain (loss) on available-for-sale investment securities				257	257	257
Total comprehensive income						\$ 6,537
Cash dividend - \$.10 per share			(595)		(595)	
Repurchase and retirement of common stock	(186,800)	(1,617)	(1,090)		(2,707)	
Stock-based compensation expense		221			221	
Stock options exercised and related tax benefit	124,460	960			960	
Balance, December 31, 2007	5,975,316	13,571	40,483	140	54,194	
Comprehensive income:						
Net income			3,834		3,834	\$ 3,834
Other comprehensive loss, net of tax:						
Net change in unrealized gain (loss) on available-for-sale investment securities				(2,453)	(2,453)	(2,453)
Total comprehensive income						\$ 1,381
Cash dividend - \$.10 per share			(598)		(598)	
Stock options exercised and related tax benefit	44,003	264			264	
Stock-based compensation expense		181			181	
Cumulative effect of adopting EITF 06-4			(316)		(316)	
Balance, September 30, 2008	6,019,319	\$ 14,016	\$ 43,403	\$ (2,313)	\$ 55,106	

See notes to unaudited condensed consolidated financial statements.

Table of Contents

**CENTRAL VALLEY COMMUNITY BANCORP**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007**

Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

(In thousands)	2008	2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 3,834	\$ 4,647
Adjustments to reconcile net income to net cash provided by operating activities:		
Net decrease in deferred loan fees	(68)	(133)
Depreciation, accretion and amortization, net	709	811
Stock-based compensation	181	144
Tax benefit from exercise of stock options	(57)	(369)
Provision for credit losses	905	360
Net realized gains on sales and calls of investment securities	(156)	(44)
Net gain on sale and disposal of equipment		(4)
Increase in bank owned life insurance, net of expenses	(188)	(169)
FHLB stock dividends	(88)	(76)
Net increase in accrued interest receivable and other assets	(1,531)	(257)
Net increase in accrued interest payable and other liabilities	1,199	368
Provision for deferred income taxes	(145)	(25)
Net cash provided by operating activities	4,595	5,253
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of available-for-sale investment securities	(43,657)	(4,044)
Purchases of held-to-maturity investment securities	(7,466)	
Proceeds from sales or calls of available-for-sale investment securities	10,782	5,699
Proceeds from maturity of available-for-sale investment securities	8,500	6,150
Proceeds from principal repayments of available-for-sale investment securities	14,436	11,327
Proceeds from principal repayments of held-to-maturity investment securities	23	
Net decrease in interest bearing deposits in other banks		205
Net FHLB stock purchases		(29)
Net increase in loans	(12,941)	(15,281)
Purchases of premises and equipment	(886)	(1,985)
Proceeds from sale of premises and equipment		4
Net cash (used in) provided by investing activities	(31,209)	2,046
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net increase (decrease) in demand, interest bearing and savings deposits	12,499	(37,755)
Net increase in time deposits	7,125	5,204
Proceeds from borrowings from Federal Home Loan Bank	164,500	67,500
Repayments to Federal Home Loan Bank	(145,600)	(59,500)
Repayments of borrowings from other financial institutions		(937)
Share repurchase and retirement		(2,402)
Proceeds from exercise of stock options	207	565
Tax benefit from exercise of stock options	57	369
Cash paid for dividends	(598)	(595)
Net cash provided by (used in) financing activities	38,190	(27,551)
Increase (decrease) in cash and cash equivalents	11,576	(20,252)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	31,644	48,116
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 43,220	\$ 27,864
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid during the period for:		
Interest expense	\$ 5,310	\$ 6,060
Income taxes	\$ 2,389	\$ 2,540
<b>Non-Cash Investing Activities:</b>		
Net pre-tax change in unrealized (losses) gains on available-for-sale investment securities	\$ (4,089)	\$ 340
<b>Non-Cash Financing Activities:</b>		
Tax benefit from stock options exercised	\$ 57	\$ 369

See notes to unaudited condensed consolidated financial statements



Table of Contents

**CENTRAL VALLEY COMMUNITY BANCORP**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Note 1. Basis of Presentation**

The interim unaudited condensed consolidated financial statements of Central Valley Community Bancorp and subsidiary have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). These interim condensed consolidated financial statements include the accounts of Central Valley Community Bancorp and its wholly owned subsidiary Central Valley Community Bank (the Bank) (collectively, the Company). All significant intercompany accounts and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The Company believes that the disclosures are adequate to make the information presented not misleading. These interim condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's 2007 Annual Report to Shareholders on Form 10-K. In the opinion of management, all adjustments, consisting of only normal recurring adjustments, necessary to present fairly the Company's financial position and shareholders' equity at September 30, 2008 and December 31, 2007, and the results of its operations for the three and nine month interim periods ended September 30, 2008 and September 30, 2007 and its cash flows for the nine month interim periods ended September 30, 2008 and September 30, 2007 have been included. Certain reclassifications have been made to prior year amounts to conform to the 2008 presentation. The results of operations for interim periods are not necessarily indicative of results for the full year.

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

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

**Note 2. Stock-Based Compensation**

The Company has three stock-based compensation plans which are described as follows:

During 1992, the Bank established a Stock Option Plan for which shares are reserved for issuance to employees and directors under incentive and nonstatutory agreements. The Company assumed all obligations under this plan as of November 15, 2000, and options to purchase shares of the Company's common stock were substituted for options to purchase shares of common stock of the Bank. Outstanding options under this plan

are exercisable until their expiration, however, no new options will be granted under this plan.

On November 15, 2000, the Company adopted, and subsequently amended on December 20, 2000, the Central Valley Community Bancorp 2000 Stock Option Plan for which 793,881 shares remain reserved for issuance for options already granted to employees and directors under incentive and nonstatutory agreements and 10,936 remain reserved for future grants. The plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the option price must be paid in full at the time it is exercised. The options under the plan expire on dates determined by the Board of Directors, but not later than ten years from the date of grant. The vesting period is determined by the Board of Directors and is generally over five years.

In May 2005, the Company adopted the Central Valley Community Bancorp 2005 Omnibus Incentive Plan (2005 Plan). The plan provides for awards in the form of incentive stock options, non-statutory stock options, stock appreciation rights, and restricted stock. The plan also allows for performance awards that may be in the form of cash or shares of the Company, including restricted stock. The maximum number of shares that can be issued with respect to all awards under the plan is 476,000. Currently under the 2005 Plan, there are 15,000 shares reserved for issuance for options already granted to employees and 461,000 remain reserved for future grants as of September 30, 2008. The plan requires that the exercise price may not be less than 100% of the fair market value of the stock at the date the option is granted, and that the option price must be paid in full at the time it is exercised. The options and awards under the plan expire on dates determined by the Board of Directors, but not later than 10 years from the date of grant. The vesting period for the options and option related stock appreciation rights is determined by the Board of Directors and is generally over five years.

#### *Stock Option Compensation*

For the nine month periods ended September 30, 2008 and 2007, the compensation cost recognized for stock option compensation was \$181,000 and \$144,000, respectively. For the quarter ended September 30, 2008 and 2007, compensation cost recognized was \$59,000 and \$48,000, respectively. The recognized tax benefit for stock option compensation expense was \$57,000 and \$370,000, for the nine month periods ended September 30, 2008 and 2007, respectively. For the three month period ended September 30, 2008, no tax benefit was recognized and for three month period in 2007, recognized tax benefits were \$205,000. As of September 30, 2008, there was \$645,000 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under all plans. The cost is expected to be recognized over a weighted average period of 3.1 years.

Table of Contents

The Company bases the fair value of the options granted on the date of grant using a Black-Scholes option pricing model that uses assumptions based on expected option life and the level of estimated forfeitures, expected stock volatility, risk free interest rate, and dividend yield. The simplified method described in SEC Staff Accounting Bulletin No. 107 was used to determine the expected term of the Company's options in 2007. Stock volatility is based on the historical volatility of the Company's stock. The risk-free rate is based on the U. S. Treasury yield curve for the periods within the contractual life of the options in effect at the time of grant. The compensation cost for options granted is based on the weighted average grant date fair value per share.

No options have been granted from either the 2000 Plan or the 2005 Plan in 2008. In the fourth quarter of 2007, the Board of Directors of the Company approved the cancellation of 15,000 stock options granted on May 1, 2006 and 78,900 stock options granted on April 23, 2007. The Board granted new options to the directors, senior managers and other employees in the same numbers and to the same employees who were holders of the cancelled options. The grant date of the new options was October 17, 2007 and the options were granted with an exercise price equal to the fair market value on the grant date of \$12.00 per share. The modification affected 60 employees and 8 directors and the total incremental compensation cost recognized in 2007 for the modification was \$29,000.

**Stock Option Activity**

A summary of the combined activity of the plans follows:

		Nine months ended September 30, 2008		
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Average Intrinsic Value (In thousands)
Options outstanding, beginning of period	861,834	\$ 7.22		\$ 3,712
Options granted				
Options exercised	(44,003)	\$ 4.71		
Options canceled	(8,950)	\$ 13.01		
Options outstanding, end of period	808,881	\$ 7.29	4.17	\$ 1,667
Options vested or expected to vest at September 30, 2008	787,051	\$ 7.14	5.24	\$ 1,667
Options exercisable, end of period	670,381	\$ 6.20	3.41	\$ 1,667

The total intrinsic value of options exercised in the nine months ended September 30, 2008 and 2007, was \$142,000 and \$900,000, respectively.

**Note 3. Earnings per share**

## Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

Basic earnings per share (EPS), which excludes dilution, is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, stock appreciation rights settled in stock or restricted stock awards, result in the issuance of common stock which shares in the earnings of the Company. There was no difference in the net income used in the calculation of basic earnings per share and diluted earnings per share.

A reconciliation of the numerators and denominators of the basic and diluted EPS computations is as follows:

### Basic Earnings Per Share

In thousands (except share and per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net income	\$ 1,214	\$ 1,576	\$ 3,834	\$ 4,647
Weighted average shares outstanding	6,009,706	5,967,762	5,992,647	5,994,131
Net income per share	\$ 0.20	\$ 0.26	\$ 0.64	\$ 0.78

### Diluted Earnings Per Share

In thousands (except share and per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net income	\$ 1,214	\$ 1,576	\$ 3,834	\$ 4,647
Weighted average shares outstanding	6,009,706	5,967,762	5,992,647	5,994,131
Effect of dilutive stock options	245,946	353,318	277,944	393,099
Weighted average shares of common stock and common stock equivalents	6,255,652	6,321,080	6,270,591	6,387,230
Net income per diluted share	\$ 0.19	\$ 0.25	\$ 0.61	\$ 0.73



Table of Contents**Note 4. Fair Value of Assets and Liabilities**

On January 1, 2008, the Company adopted Financial Accounting Standards Board (FASB) Statement No. 157 (SFAS 157), *Fair Value Measurements*. SFAS 157 defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States of America (GAAP) and expands disclosures about fair value measurements. There was no cumulative effect adjustment to beginning retained earnings recorded upon adoption and no impact on the financial statements in the nine month period ended September 30, 2008.

The following table presents information about the Company's assets and liabilities measured at fair value on a recurring and non recurring basis as of September 30, 2008, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

(In thousands)	Fair Value Measurements at September 30, 2008, Using				
	Fair Value September 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Assets and liabilities measured on a recurring basis:					
Available-for-sale investment securities	\$ 90,533	\$ 2,384	\$ 77,670	\$ 10,479	
Total assets and liabilities measured at fair value on a recurring basis	\$ 90,533	\$ 2,384	\$ 77,670	\$ 10,479	
Assets and liabilities measured on a non-recurring basis:					
Impaired loans	\$ 1,419		\$ 1,419		
Total assets and liabilities measured at fair value on a non-recurring basis	\$ 1,419		\$ 1,419		

The fair value of available-for-sale investment securities is based on actual market price determinations from third party evaluation vendors. The fair value of impaired loans is based on the fair value of the collateral for all collateral dependent loans and for other impaired loans is estimated using a discounted cash flow model.

**Fair Value Measurements Using Significant Unobservable Inputs**

(Level 3)

(In thousands)	Available-for-sale Investment Securities	
	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2008
Beginning balance	\$ 7,509	\$ 9,011
Total gains or losses (realized/unrealized)		
Included in earnings (or changes in net assets)	3	3
Included in other comprehensive income	452	482
Purchases, sales and principal payments	2,515	983
Ending balance	\$ 10,479	\$ 10,479

Table of Contents

**Note 5. Comprehensive Income**

Total comprehensive income is comprised of net earnings and net unrealized gains and losses on available-for-sale securities, which is the Company's only source of other comprehensive income. Total comprehensive income for the three-month periods ended September 30, 2008 and 2007 was \$848,000 and \$2,176,000 and was \$1,381,000 and \$4,851,000 for the nine month periods ended September 30, 2008 and 2007, respectively.

**Note 6. Commitments and Contingencies**

## Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

In the normal course of business, the Company is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract or notional amounts of these instruments reflect the extent of involvement the Company has in particular classes of financial instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for loans.

Commitments to extend credit amounting to \$121,573,000 and \$135,638,000 were outstanding at September 30, 2008 and December 31, 2007, respectively. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee.

Undisbursed lines of credit amounting to \$66,589,000 and \$77,933,000 were outstanding at September 30, 2008 and December 31, 2007, respectively. Undisbursed lines of credit are revolving lines of credit whereby customers can repay principal and advance principal during the term of the loan at their discretion and most expire between one and twelve months.

The Company has undisbursed portions of construction loans totaling \$13,784,000 and \$15,868,000 as of September 30, 2008 and December 31, 2007, respectively. These commitments are agreements to lend to a customer, subject to meeting certain construction progress requirements. The underlying construction loans have fixed expiration dates.

Standby letters of credit and financial guarantees amounting to \$400,000 and \$969,000 were outstanding at September 30, 2008 and December 31, 2007, respectively. Standby letters of credit and financial guarantees are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. Most guarantees carry a one year term or less. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at September 30, 2008 and December 31, 2007. The Company recognizes these fees as revenue over the term of the commitment or when the commitment is used.

The Company generally requires collateral or other security to support financial instruments with credit risk. Management does not anticipate any material loss will result from the outstanding commitments to extend credit, standby letters of credit and financial guarantees.

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

### **Note 7. Income Taxes**

The Company files its income taxes on a consolidated basis with its subsidiaries. The allocation of income tax expense (benefit) represents each entity's proportionate share of the consolidated provision for income taxes. Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. On the consolidated balance sheets, net deferred tax assets are included in accrued interest receivable and other assets.

### **Note 6. Commitments and Contingencies**



Table of Contents

Accounting for uncertainty in income taxes - The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. The Company recognizes accrued interest and penalties related to unrecognized tax benefits as a component of tax expense in the consolidated statements of income. There have been no significant changes to unrecognized tax benefits or accrued interest and penalties for the quarter ended September 30, 2008.

**Note 8. Stock Repurchase**

On November 20, 2007, the Board of Directors approved a stock repurchase plan authorizing the purchase of shares of the Company's common stock up to a total cost of approximately \$1,000,000 during the period from November 21, 2007 to May 21, 2008. Under the plan, the Company repurchased 24,300 shares in 2007 at an average price of \$12.55 for a total cost of \$305,000. No shares have been repurchased under the plan in 2008 and the plan expired May 20, 2008.

**Note 9. Borrowing Arrangements**

Federal Home Loan Bank Advances: Advances from the Federal Home Loan Bank (FHLB) of San Francisco consisted of the following:

<b><u>September 30, 2008</u></b>			
<b>(In thousands)</b>			
<b>Amount</b>	<b>Rate</b>	<b>Maturity Date</b>	
\$ 3,890	2.26%	November 6, 2008	
11,110	2.27%	November 6, 2008	
4,900	2.24%	November 7, 2008	
5,000	2.73%	February 5, 2010	
5,000	3.00%	February 7, 2011	
5,000	3.10%	February 14, 2011	
4,000	3.59%	February 13, 2013	
38,900			
(19,900)	Less short-term portion		
\$ 19,000	Long-term debt		

<b><u>December 31, 2007</u></b>			
<b>(In thousands)</b>			
<b>Amount</b>	<b>Rate</b>	<b>Maturity Date</b>	
\$ 10,000	4.37%	January 10, 2008	

**Note 6. Commitments and Contingencies**

Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

10,000	4.49%	January 9, 2008
20,000		
	Less short-term	
(20,000)	portion	
\$	Long-term debt	

FHLB advances are secured by investment securities with amortized costs totaling \$60,305,000 and \$24,231,000 and market values totaling \$57,225,000 and \$24,203,000 at September 30, 2008 and December 31, 2007, respectively. The Bank's credit limit varies according to the amount and composition of the investment and loan portfolios pledged as collateral.

**Note 10. Pending Acquisition**

On May 28, 2008, Central Valley Community Bancorp and Service 1<sup>st</sup> Bancorp, headquartered in Tracy, California entered into a Reorganization Agreement and Plan of Merger. Under the terms of the agreement, Service 1<sup>st</sup> Bancorp will merge with and into Central Valley Community Bancorp (the Merger), and the Service 1<sup>st</sup> Bancorp subsidiary, Service 1<sup>st</sup> Bank, with branches in Tracy, Stockton and Lodi, will merge with and into Central Valley Community Bancorp's subsidiary, Central Valley Community Bank (the Bank Merger). Regulatory merger approvals have been received from the Federal Deposit Insurance Corporation, the California Department of Financial Institutions, the Board of Governors of the Federal Reserve System, and the Securities and Exchange Commission. The shareholders of Central Valley Community Bancorp and of Service 1<sup>st</sup> Bancorp approved the merger at special meetings held on October 10, 2008. The Merger and Bank Merger are currently projected to be completed in the fourth quarter of 2008.

Under the merger agreement, Service 1<sup>st</sup> Bancorp shareholders will receive in exchange for each share of Bancorp common stock held, cash in the amount of \$2.50 and shares of Central Valley Community Bancorp common stock based on a exchange ratio of 0.681818, representing an aggregate cash amount of \$5,971,848 and an aggregate share amount of 1,628,686, subject to certain adjustments that will be finalized prior to completion of the Merger, and subject to a cash holdback of \$3,500,000, approximately \$1.33 per share, to be deposited into an escrow account pending the outcome of certain litigation matters.

Table of Contents

**Note 11. New Accounting Pronouncements**

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS No. 162). This standard identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with GAAP. The provisions of SFAS No. 162 did not have a material impact on the Company's condensed consolidated financial statements.

On October 10, 2008, the FASB issued FSP FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active. The FSP clarifies the application of FASB Statement No. 157, Fair Value Measurements, in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The FSP is effective immediately, and includes prior period financial statements that have not yet been issued, and therefore the Company is subject to the provision of the FSP effective September 30, 2008. The implementation of FSP FAS 157-3 did not affect the Company's fair value measurement as of September 30, 2008.



Table of Contents

**ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

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

When the Company uses in this Quarterly Report on Form 10-Q the words anticipate, estimate, expect, project, intend, commit, and similar expressions, the Company intends to identify forward-looking statements. Such statements are not guarantees of performance and are subject to certain risks, uncertainties and assumptions, including those described in this Quarterly Report on Form 10-Q. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, expected, projected, intended, committed or believed. The future results and shareholder values of the Company may differ materially from those expressed in these forward-looking statements. Many of the factors that will determine these results and values are beyond the Company's ability to control or predict. For those statements, the Company claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

On January 1, 2008, the Company adopted Financial Accounting Standards Board (FASB) issued Statement No. 157 (SFAS 157), *Fair Value Measurements*. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. The Company adopted SFAS 157 on January 1, 2008 and there was no cumulative effect adjustment to beginning retained earnings recorded upon adoption and no impact on the financial statements in the first nine months of 2008.

In September 2006, the FASB ratified the consensus reached by the Task Force on Issue No. 06-4 (EITF 06-04), *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. A question arose when an employer enters into an endorsement split-dollar life insurance arrangement related to whether the employer should recognize a liability for the future benefits or premiums to be provided to the employee. EITF 06-04 indicates that an employer should recognize a liability for future benefits and that a liability for the benefit obligation has not been settled through the purchase of an endorsement type policy. The Company adopted the provisions of EITF 06-04 on January 1, 2008 and a liability of \$316,000 was recorded with the corresponding reduction as a cumulative-effect adjustment to beginning retained earnings.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115*. SFAS No. 159 provides entities with an option to report certain financial assets and liabilities at fair

## Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

value with changes in fair value reported in earnings and requires additional disclosures related to an entity's election to use fair value reporting. It also requires entities to display the fair value of those assets and liabilities for which the entity has elected to use fair value on the face of the balance sheet. SFAS No. 159 was effective for fiscal years beginning after November 15, 2007. The Company adopted SFAS No. 159 on January 1, 2008 and did not elect the fair value option for any of its financial instruments.

On October 10, 2008, the FASB issued FSP FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active. The FSP clarifies the application of FASB Statement No. 157, Fair Value Measurements, in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The FSP is effective immediately, and includes prior period financial statements that have not yet been issued, and therefore the Company is subject to the provision of the FSP effective September 30, 2008. The implementation of FSP FAS 157-3 did not affect the Company's fair value measurement as of September 30, 2008.

There have been no other changes to the Company's critical accounting policies from those discussed in the Company's 2007 Annual Report to Shareholders on Form 10-K. This discussion should be read in conjunction with our unaudited condensed consolidated financial statements, including the notes thereto, appearing elsewhere in this report.

Table of Contents

**OVERVIEW**

**Third quarter 2008**

In the third quarter of 2008, our consolidated net income was \$1,214,000 compared to net income of \$1,576,000 for the same period in 2007. Diluted EPS was \$0.19 for the third quarter 2008 compared to \$0.25 for the third quarter 2007. The decrease in net income was due to the increase in the provision for loan losses of \$515,000 in the third quarter of 2008 compared to the same period in 2007 and decreasing yields on earning assets outpacing the decreases in rates paid on interest bearing liabilities. Net interest income declined \$163,000 for the quarter ended September 30, 2008 from the same period in the prior year. The net interest margin decreased 61 basis points for the third quarter of 2008 compared to the same period in 2007. Average total interest bearing liabilities increased 16.9% while average earning assets increased 9.2%. Also contributing to the decrease in net income for the third quarter were increases in non-interest expenses of \$120,000. These items were offset by increases in non interest income of \$307,000 and decreases in the provision for income taxes of \$129,000.

Annualized return on average equity for the third quarter of 2008 was 8.82% compared to 12.21% for the same period in 2007. Total average equity was \$55,060,000 for the third quarter 2008 compared to \$51,626,000 for the third quarter 2007. Equity increased primarily as a result of the net income included in retained earnings and proceeds from exercise of stock options offset by an increase in other comprehensive loss.

**First Nine Months of 2008**

For the nine months ended September 30, 2008, the Company's consolidated net income was \$3,834,000 compared to \$4,647,000 for same period in 2007. Diluted EPS was \$0.61 for the nine months ended September 30, 2008 compared to \$0.73 for the same period in 2007.

Annualized return on average equity for the nine months ended September 30, 2008 was 9.36% compared to 12.15% for the same period in 2007. Annualized return on average assets for the nine months ended September 30, 2008 was 1.01% compared to 1.30% for the same period in 2007. Total average equity was \$54,620,000 for the nine months ended September 30, 2008 compared to \$51,006,000 for the same period in 2007. Equity increased primarily as a result of the net income and proceeds from the exercise of stock options offset by an increase in other comprehensive loss.

In comparing the first three quarters of 2008 to the same period in 2007, total loans continued to increase. Total average earning assets increased \$25,783,000 or 5.9%, with the largest increase in average loans which increased \$19,178,000 or 5.8% in the first nine months of 2008 compared to the nine months ended September 30, 2007. Over the same period average interest bearing liabilities increased \$31,479,000 or 11.0%. While yields on earning assets decreased 85 basis points, the rates paid on interest bearing liabilities decreased at a slower rate by 63 basis points. As a result, net interest margin declined by 51 basis points from September 30, 2007 to September 30, 2008.

Although non-accrual loans have increased to \$1,419,000 at September 30, 2008, compared to \$179,000 at December 31, 2007 and \$11,000 at September 30, 2007, the Company believes our asset quality continues to be a strength. The Company had no other real estate owned at September 30, 2008, December 31, 2007, or September 30, 2007.

**Central Valley Community Bancorp (Company)**

We are a central California-based bank holding company for a one-bank subsidiary, Central Valley Community Bank (Bank). We provide traditional commercial banking services to small and medium-sized businesses and individuals in the communities along the Highway 99 corridor in the Fresno and Madera Counties of central California. Additionally, we have a private banking office in Sacramento County and a loan production office in Modesto, California. As a bank holding company, the Company is subject to supervision, examination and regulation by the Federal Reserve Bank. We recently entered into a Reorganization Agreement and Plan of Merger with Service 1st Bancorp. Service 1st Bank has branches in Tracy, Stockton and Lodi, California. Regulatory merger approvals have been received from the Federal Deposit Insurance Corporation, the California Department of Financial Institutions, the Board of Governors of the Federal Reserve System, and the Securities and Exchange Commission. The shareholders of Central Valley Community Bancorp and of Service 1<sup>st</sup> Bancorp approved the merger at special meetings held on October 10, 2008. The Merger and Bank Merger are currently projected to be completed in the fourth quarter of 2008.

At September 30, 2008, we had total gross loans of \$353,878,000, total assets of \$524,636,000, total deposits of \$422,186,000, and shareholders equity of \$55,106,000.

Table of Contents

**Central Valley Community Bank (Bank)**

The Bank commenced operations in January 1980 as a state-chartered bank. As a state-chartered bank, the Bank is subject to primary supervision, examination and regulation by the Department of Financial Institutions. The Bank's deposits are insured by the Federal Deposit Insurance Corporation up to the applicable limits thereof, which have been increased to \$250,000 per depositor through December 31, 2009, and the Bank is subject to supervision, examination and regulations of the FDIC.

The Bank operates 12 branches which serve the communities of Fresno, Clovis, Kerman, Prather, Oakhurst, Madera, and Sacramento, California; and a loan production office which serves the Modesto, California community. Additionally the Bank operates Real Estate, Agribusiness and SBA departments that originate loans in California. According to the June 30, 2008 FDIC data, the Bank's seven branches in Fresno County (Clovis, Fresno, Kerman, and Prather) had a 4.0% combined deposit market share of all depositories including credit unions, thrifts, and savings banks.

Branch expansions and the anticipated merger with Service 1st Bank provide the Company with opportunities to expand its loan and deposit base. The merger will add three branch offices located in Tracy, Lodi and Stockton, California. During 2007 we opened a new loan production office in Modesto, California. During the second quarter of 2008 we relocated our Herndon & Fowler branch from an in-store location to a new larger stand alone branch location. The Bank anticipates additional branch openings in the future to meet the growing service needs of its customers. Management expects that new offices initially will have a negative impact on earnings until the volume of business grows to cover fixed overhead expenses.

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

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

- Return to our stockholders;
- Return on average assets;
- Return on average equity;
- Asset quality;
- Asset growth; and
- Operating efficiency.

Return to Our Stockholders

Our return to our stockholders is measured in the form of return on average equity (ROE). Our annualized ROE was 9.36% for the nine months ended September 30, 2008 compared to 12.13% for the year ended December 31, 2007 and 12.15% for the nine months ended September 30, 2007. Peer ROE, as of June 30, 2008 was 7.48%. Our net income for the nine months ended September 30, 2008 decreased \$813,000 or 17.5% to \$3,834,000 compared to \$4,647,000 for the nine months ended September 30, 2007. Net income decreased due to decreases in net interest income, and increases in the provision for credit losses and non-interest expenses, offset by an increase in non-interest income and a reduction in the provision for income taxes. Diluted EPS was \$0.61 for the nine months ended September 30, 2008 and \$0.73 for the same period in 2007.

Return on Average Assets

Our return on average assets (ROA) is a measure we use to compare our performance with other banks and bank holding companies. Our annualized ROA for the nine months ended September 30, 2008 was 1.01% compared to 1.32% for the year ended December 31, 2007 and 1.30% for the nine months ended September 30, 2007. The decrease in ROA compared to December 2007 is due to the decrease in net income relative to our increase in average assets. Average assets for the nine months ended September 30, 2008 were \$503,847,000 an increase of \$26,526,000 from the \$477,321,000 for the year ended December 31, 2007. Annualized ROA for our peer group was 0.69% at June 30, 2008. Peer group data from SNL Financial includes certain bank holding companies in central California with assets from \$300 million to \$1 billion.

Development of Core Earnings

Over the past several years, we have focused on not only improving net income, but improving the consistency of our revenue streams in order to create more predictable future earnings and reduce the effect of changes in our operating environment on our net income. Specifically, we have focused on net interest income through a variety of processes, including increases in average interest earning assets as a result of loan generation and retention, and minimizing the effects of the recent interest rate decline on our net interest margin by focusing on core deposits and managing the cost of funds. The Company's net interest margin (fully tax equivalent basis) was 5.21% for the first three quarters of 2008, compared to 5.72% for the same period in 2007. The decrease in net interest margin is principally due to a decrease in the Company's yield on earning assets which was greater than the decrease in our cost of funds. In comparing the two periods, the effective yield on total earning assets decreased 85 basis points while the cost of total interest bearing liabilities decreased 63 basis points and the cost of total deposits decreased 42 basis points. The Company's total cost of deposits for the nine months ended September 30, 2008 was 1.48% compared to 1.90% for the same period in 2007. The Company has less exposure than many of its competitors to such interest expense increases, as 30.9% of its average deposits are non-interest bearing. Net interest income for the first three quarters of 2008 was \$17,598,000 a decrease of \$686,000 from \$18,284,000 for the same period in 2007.

Our non-interest income is generally made up of service charges and fees on deposit accounts, fee income from loan placements and other services, FHLB stock dividends, and gains from sales of investment securities. Non-interest income for the first nine months of 2008 increased \$544,000 or 16.2% to \$3,894,000 compared to \$3,350,000 for the nine months ended September 30, 2007 mainly due to increases in service charge income, an increase in gains on sales of investment securities and other income. Further detail of non-interest income is provided below.

Table of Contents

Asset Quality

For all banks and bank holding companies, asset quality has a significant impact on the overall financial condition and results of operations. Asset quality is measured in terms of percentage of total loans and total assets, and is a key element in estimating the future earnings of a company. The Company had non-performing loans totaling \$1,419,000 or 0.40% of total loans as of September 30, 2008, \$179,000 or 0.05% of total loans at December 31, 2007, and \$11,000 or 0.003% of total loans as of September 30, 2007. Peer non-performing loans to total loans as of June 30, 2008 averaged 2.66%. Management maintains certain loans that have been brought current by the borrower (less than 30 days delinquent) on non-accrual status until such time as management has determined that the loans are likely to remain current in future periods. The Company did not have any other real estate owned at September 30, 2008, December 31, 2007, or September 30, 2007.

Asset Growth

As revenues from both net interest income and non-interest income are a function of asset size, the continued growth in assets has a direct impact in increasing net income and therefore ROE and ROA. The majority of our assets are loans and investment securities, and the majority of our liabilities are deposits, and therefore the ability to generate deposits as a funding source for loans and investments is fundamental to our asset growth.

Total assets increased 8.5% during the first nine months of 2008 from \$483,685,000 as of December 31, 2007 to \$524,636,000 as of September 30, 2008. Total gross loans increased 3.7% to \$353,878,000 as of September 30, 2008 compared to \$341,128,000 as of December 31, 2007. Total deposits increased 4.9% to \$422,186,000 as of September 30, 2008 compared to \$402,562,000 as of December 31, 2007. We continue to be below our peers in the level of our loan to deposit ratio. Our loan to deposit ratio at September 30, 2008 remained consistent at 83.8% compared to 84.7% at December 31, 2007. The average loan to deposit ratio of our peers was 96.4% at June 30, 2008. Further discussion of loans and deposits is below.

Operating Efficiency

Operating efficiency is the measure of how efficiently earnings before taxes are generated as a percentage of revenue. The Company's efficiency ratio (operating expenses, excluding amortization of intangibles, divided by net interest income plus non-interest income, excluding gains from sales of securities) was 69.2% for the first nine months of 2008 compared to 65.6% for the nine months ended September 30, 2007. The decline in the efficiency ratio is due to an increase in operating expenses and a decrease in revenues, primarily due to the decrease in interest rates since September of 2007. The Company's net interest income before provision for credit losses plus non-interest income decreased 0.7% to \$21,492,000 for the nine months ended September 30, 2008 compared to \$21,634,000 for the same period in 2007, while operating expenses increased 4.2% to \$14,922,000 from \$14,325,000 for the same period in 2008 compared to 2007.

**RESULTS OF OPERATIONS**

**Net Income for the First Nine Months of 2008 Compared to the Nine Months Ended September 30, 2007:**

Net income decreased to \$3,834,000 for the nine months ended September 30, 2008 compared to \$4,647,000 for the nine months ended September 30, 2007. Basic earnings per share were \$0.64 and \$0.78 for the nine months ended September 30, 2008 and 2007, respectively. Diluted earnings per share were \$0.61 for the nine months ended September 30, 2008 and \$0.73 for the same period in 2007. Annualized ROE was 9.36% for the nine months ended September 30, 2008 compared to 12.15% for the nine months ended September 30, 2007. Annualized ROA for the nine months ended September 30, 2008 was 1.01% compared to 1.30% for the nine months ended September 30, 2007.

Net income for the nine months ended September 30, 2008 compared to the same period in the prior year decreased due mainly to decreases in net interest income and increases in the provision for credit losses and non-interest expenses, offset by an increase in non-interest income and a decrease in the provision for income taxes. Net interest income decreased due to a decrease in the yield on interest earning assets and an increase in the level of average interest bearing-liabilities, partially offset by a lesser decrease in our cost of interest-bearing liabilities and an increase in the level of our total average interest earning assets. The provision for credit losses increased as a result of the growth in loans and our ongoing assessment of the inherent risks and probable losses in our portfolio and the related required level of allowance for loan losses. Non interest revenues increase primarily from service charges and gains on sales of investment securities. Non-interest expenses increased primarily due to salaries and benefits and other expenses. Further discussion of non-interest expenses is below. The decrease in the provision for income taxes is reflective of the overall decrease in net income.

### **Interest Income and Expense**

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

The following table sets forth a summary of average balances with corresponding interest income and interest expense as well as average yield and cost information for the periods presented. Average balances are derived from daily balances, and non-accrual loans are not included as interest earning assets for purposes of this table.



Table of Contents

## CENTRAL VALLEY COMMUNITY BANCORP

## SCHEDULE OF AVERAGE BALANCES AND AVERAGE YIELDS AND RATES

(Dollars in thousands)

	FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008			FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007		
	Average Balance	Interest Income/ Expense	Average Interest Rate	Average Balance	Interest Income/ Expense	Average Interest Rate
<b>ASSETS</b>						
Interest-earning deposits in other banks	\$ 1,661	\$ 38	3.05%	\$ 211	\$ 5	3.16%
Securities						
Taxable securities	73,230	3,088	5.62%	69,822	2,570	4.91%
Non-taxable securities (1)	24,472	1,032	5.62%	23,942	1,003	5.59%
Total investment securities	97,702	4,120	5.62%	93,764	3,573	5.08%
Federal funds sold	12,099	206	2.27%	10,499	408	5.18%
Total	111,462	4,364	5.22%	104,474	3,986	5.09%
Loans (2) (3)	348,318	18,851	7.23%	329,635	20,733	8.39%
Federal Home Loan Bank stock	2,061	88	5.69%	1,949	76	5.20%
<b>Total interest-earning assets</b>	<b>461,841</b>	<b>23,303</b>	<b>6.73%</b>	<b>436,058</b>	<b>24,795</b>	<b>7.58%</b>
Allowance for credit losses	(4,038)			(3,771)		
Non-accrual loans	554			59		
Cash and due from banks	17,105			16,844		
Bank premises and equipment	5,908			5,709		
Other non-earning assets	22,477			21,953		
<b>Total average assets</b>	<b>\$ 503,847</b>			<b>\$ 476,852</b>		
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>						
Interest-bearing liabilities:						
Savings and NOW accounts	\$ 72,867	189	0.35%	\$ 73,584	379	0.69%
Money market accounts	98,090	1,492	2.03%	98,780	1,975	2.67%
Time certificates of deposit, under \$100,000	69,287	1,479	2.85%	47,887	1,528	4.25%
Time certificates of deposit, \$100,000 and over	43,930	1,420	4.32%	61,827	2,069	4.46%
Total interest-bearing deposits	284,174	4,580	2.15%	282,078	5,951	2.81%
Other borrowed funds	32,562	686	2.81%	3,179	143	6.00%
<b>Total interest-bearing liabilities</b>	<b>316,736</b>	<b>5,266</b>	<b>2.22%</b>	<b>285,257</b>	<b>6,094</b>	<b>2.85%</b>
Non-interest bearing demand deposits	127,033			135,408		
Other liabilities	5,458			5,181		
Shareholders equity	54,620			51,006		
Total average liabilities and shareholders equity	\$ 503,847			\$ 476,852		
Interest income and rate earned on average earning assets		23,303	6.73%		24,795	7.58%
Interest expense and interest cost related to average interest-bearing liabilities		5,266	2.22%		6,094	2.85%
<b>Net interest income and net interest margin (4)</b>		<b>\$ 18,037</b>	<b>5.21%</b>		<b>\$ 18,701</b>	<b>5.72%</b>

- (1) Calculated on a fully tax equivalent basis, which includes Federal tax benefits relating to income earned on municipal bonds totaling \$351 and \$341 in 2008 and 2007, respectively.
- (2) Loan interest income includes net loan fees of \$571 in 2008 and \$586 in 2007.
- (3) Average loans do not include non-accrual loans.
- (4) Net interest margin is computed by dividing net interest income by total average interest-earning assets.

Interest and fee income from loans decreased \$1,882,000 or 9.1% in the first nine months of 2008 compared to the same period in 2007.

Average total loans for the first nine months of 2008 increased 5.8% to \$348,872,000 compared to \$329,694,000 for the same period in 2007.

While loan growth was positive, the yield on average total loans decreased 116 basis points to 7.23% for the first nine months of 2008 compared to 8.39% for the same period in 2007 largely due to the 325 basis points decline in interest rates by the Federal Reserve Bank since September 2007 coupled with the competitive loan environment in the Central Valley.

Interest income from total investments (total investments include investment securities, Federal funds sold, interest bearing deposits with other banks, and other securities) increased \$368,000 in the first nine months of 2008 compared to the same period in 2007, mainly due to the 4.2% increase in average balances of total investments and the overall increase in yields earned. Income from investments represents 22.8% of net interest income for the nine months ended September 30, 2008 compared to 19.9% for the same period in 2007.

Table of Contents

In an effort to increase yields, without accepting unreasonable risk, a significant portion of the investment portfolio is in high quality mortgage-backed securities (MBS) and collateralized mortgage obligations (CMOs). At September 30, 2008, we held \$65,501,000 or 71.2% of the total market value of the available-for-sale investment portfolio in MBS and CMOs with an average yield of 5.9%. We understand the interest rate risks and prepayment risks associated with MBS and CMOs. In a declining interest rate environment, prepayments from MBS and CMOs could be expected to increase and the expected life of the investment could be expected to shorten. Conversely, if interest rates increase, prepayments could be expected to decline and the average life of the MBS and CMOs could be expected to extend. Additionally, changes in interest rates are reflected in the market value of the investment portfolio. During declining interest rates, the investment portfolio could be expected to have market value gains and in increasing rate environments, the market value could be expected to be negative. The change in market value, net of tax-effect, of the available-for-sale investment portfolio is also reflected in the Company's equity. At September 30, 2008, the average life of the investment portfolio was 4.9 years and the market value reflected a pre-tax unrealized loss of \$3,855,000. The Company reviewed its holdings in MBS and CMOs recently and none are invested in sub-prime mortgage instruments. Lack of liquidity in the current market for certain mortgage backed securities has resulted in market value declines despite decreasing interest rates which normally have a favorable impact on yields earned and pricing.

A component of the Company's strategic plan has been to use its investment portfolio to offset, in part, its interest rate risk relating to variable rate loans. At September 30, 2008, an immediate rate increase of 200 basis points would result in an estimated decrease in the market value of the investment portfolio by approximately \$6,717,000. Conversely, with an immediate rate decrease of 200 basis points, the estimated increase in the market value of the investment portfolio is \$6,940,000. The modeling environment assumes management would take no action during an immediate shock of 200 basis points. The likelihood of immediate changes of 200 basis points is contrary to expectation. However, the Company uses those increments to measure its interest rate risk in accordance with regulatory requirements and to measure the possible future risk in the investment portfolio. For further discussion of the Company's market risk, refer to Item 3 - Quantitative and Qualitative Disclosures about Market Risk.

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

Total interest income for the first nine months of 2008 decreased \$1,514,000, to \$22,864,000 compared to \$24,378,000 for the nine months ended September 30, 2007. The decrease was due to the 85 basis point decrease in the yield on total interest earning assets offset by the 5.9% increase in those assets. The yield on interest earning assets decreased to 6.73% for the nine months ended September 30, 2008 from 7.58% for the nine months ended September 30, 2007. Average interest earning assets increased to \$461,841,000 for the nine months ended September 30, 2008 compared to \$436,058,000 for the nine months ended September 30, 2007. The \$25,783,000 increase in average earning assets can be attributed to our own organic growth in loans and increases investments funded by borrowings from the FHLB.

Interest expense on deposits for the nine months ended September 30, 2008 decreased \$1,371,000 or 23.0% to \$4,580,000 compared to \$5,951,000 for the nine months ended September 30, 2007. This decrease was due to an 66 basis point decrease in deposit rates due to the repricing of deposits in the lower current interest rate environment, partially offset by a \$2,096,000 or less than 1% increase in the volume of average interest bearing deposits. Average interest-bearing deposits were \$284,174,000 for the nine months ended September 30, 2008 compared to \$282,078,000 for the same period ended September 30, 2007.

Average other borrowed funds increased to \$32,562,000 with an effective rate of 2.81% for the nine months ended September 30, 2008 compared to \$3,179,000 with an effective rate of 6.00% for the nine months ended September 30, 2007. As a result of the significant increase in the average balances having a greater impact than the significant decrease in the rates paid, interest expense on other borrowed funds increased \$543,000 to \$686,000 for the nine months ended September 30, 2008 from \$143,000 for the nine months ended September 30, 2007. Other

## Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

borrowings are advances from the Federal Home Loan Bank (FHLB). The FHLB advances are fixed rate, secured, short-term and long term borrowings. Short-term advances were utilized to provide liquidity during the period and long-term advances were utilized as part of a leverage strategy employed in first quarter of 2008 whereby we purchased investment securities funded by FHLB borrowings.

The cost of total deposits, calculated by dividing annualized interest expense on interest bearing deposits by total deposits, was 1.48% for the first three quarters of 2008 compared to 1.90% for the same period in 2007. Average non-interest bearing demand deposits decreased 6.2% to \$127,033,000 for the nine months ended September 30, 2008 from \$135,408,000 for the nine months ended September 30, 2007. The cost of all of our interest bearing liabilities decreased 63 basis points to 2.22% for the nine months ended September 30, 2008 compared to 2.85% for the nine months ended September 30, 2007. Average transaction accounts (including interest bearing checking, money market accounts and non interest bearing demand deposits) decreased 2.5% to \$279,477,000 for the nine months ended September 30, 2008 compared to \$286,760,000 for the nine months ended September 30, 2007. Average time certificates of deposits increased 3.2% to \$113,217,000 for the nine months ended September 30, 2008 compared to \$109,714,000 for the nine months ended September 30, 2007.

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

Net interest income before provision for credit losses for the nine months ended September 30, 2008 decreased by \$686,000 or 3.8% to \$17,598,000 compared to \$18,284,000 for the nine months ended September 30, 2007. This decrease was primarily due to the 51 basis point decline in the net interest margin partially offset by an increase in average interest earning assets. Average interest earning assets were \$461,841,000 for the nine months ended September 30, 2008 and the net interest margin was 5.21% compared to \$436,058,000 and a net interest margin of 5.72% for the nine months ended September 30, 2007. For a discussion of the repricing of our assets and liabilities, see Item 3 Quantitative and Qualitative Disclosure about Market Risk.

Table of Contents**Provision for Credit Losses**

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

The establishment of an adequate credit allowance is based on both an accurate risk rating system and loan portfolio management tools. The Board has established initial responsibility for the accuracy of credit risk grades with the individual credit officer. The grading is then submitted to the Chief Credit Administrator (CCA), who reviews the grades for accuracy and makes recommendations to Credit Review who gives final approval. The risk grading and reserve allocations are analyzed annually by a third party credit reviewer and by various regulatory agencies.

Quarterly, the CCA sets the specific reserve for all adversely risk-graded credits. This process includes the utilization of loan delinquency reports, classified asset reports, and portfolio concentration reports to assist in accurately assessing credit risk and establishing appropriate reserves. Reserves are also allocated to credits that are not adversely graded. Historical loss experience within the portfolio along with peer bank loss experiences are used in determining the level of the reserves held.

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

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

Loan Type (Dollars in thousands)	September 30, 2008 Amount	% of Loans in Each Category to Total Loans	December 31, 2007 Amount	% of Loans in Each Category to Total Loans
Commercial and industrial	\$ 1,155	28.8%	\$ 1,254	27.1%
Agricultural land and production	384	8.0%	501	9.4%
Real estate	1,659	43.2%	1,353	40.3%
Real estate - construction and other land loans	823	10.6%	312	14.2%
Equity loans and lines of credit	190	7.7%	157	7.2%
Consumer and installment	204	1.6%	236	1.7%
Other	118	0.1%	74	0.1%
Total allowance for credit losses	\$ 4,533		\$ 3,887	

## Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

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

Additions to the allowance for credit losses in the first nine months of 2008 were \$905,000 compared to \$360,000 for the same period in 2007. The increase in 2008 is due to our assessment of the required level and overall adequacy of the allowance for credit losses and growth in the portfolio. During the nine months ended September 30, 2008, the Company had net charge offs totaling \$259,000 compared \$339,000 for the same period in 2007.

The Company had non-performing loans totaling \$1,419,000 as of September 30, 2008, \$179,000 as of December 31, 2007, and \$11,000 as of September 30, 2007. Non-performing loans as a percentage of loans were 0.40% at September 30, 2008 compared to 0.05% at December 31, 2007, and 0.003% at September 30, 2007. The Company did not have any other real estate owned at September 30, 2008, December 31, 2007 or September 30, 2007.

Table of Contents

The net charge off ratio, which reflects net charge-offs to average loans for the nine months ended September 30, 2008 was 0.07% compared to 0.10% for the same period in 2007. The annual net charge off ratios for 2007, 2006, and 2005 were 0.12%, 0.11% and 0.22%, respectively.

Based on information currently available, management believes that the allowance for credit losses is adequate to absorb estimated probable losses in the portfolio. However, no assurance can be given that we may not sustain charge-offs which are in excess of the allowance in any given period. Refer to Allowance for Credit Losses below for further information on the allowance for credit losses.

**Non-Interest Income**

Non-interest income is comprised of customer service charges, loan placement fees, gains on sales of investment securities, appreciation in cash surrender value of bank owned life insurance, Federal Home Loan Bank stock dividends, and other income. Non-interest income was \$3,894,000 for the nine months ended September 30, 2008 compared to \$3,350,000 for the same period ended September 30, 2007. The \$544,000 increase in non-interest income was primarily due to increases in customer service charges, gains on sales of investment securities and other income.

Customer service charges increased \$409,000 to \$2,473,000 for the first nine months of 2008 compared to \$2,064,000 for the same period in 2007, mainly due to an increase in transaction account service charge income. These increases are mainly due to an increase in the activity level as the average number of transaction accounts has increased and an increase in fees generated by the overdraft protection program.

Net realized gains on sales of investment securities in the first nine months of 2008 were \$156,000 compared to \$44,000 for the same period in 2007. In the third quarter we sold certain investments with a book value of \$10,626,000 and purchased \$13,620,000 in new securities to reposition the portfolio in an effort to increase yield.

Income from the appreciation in cash surrender value of bank owned life insurance (BOLI) increased \$20,000 comparing the first nine months of 2008 with the same period in 2007, due to the average balances of the BOLI increasing while the yield remained relatively unchanged. The Bank's salary continuation, deferred compensation plans and the related BOLI are used as a retention tool for directors and key executives of the Bank.

The Bank holds stock from the Federal Home Loan Bank in relationship with the borrowing capacity and generally earns quarterly dividends. We currently hold \$2,110,000 in FHLB stock. Dividends in the first nine months of 2008 increased \$12,000 compared to the same period in 2007.

Other income increased \$82,000 for the first nine months of 2008 compared to the same period in 2007. The increase can be attributed primarily to an increase in merchant fees from bankcards.

**Non-Interest Expenses**

Salaries and employee benefits, occupancy, professional services, and data processing are the major categories of non-interest expenses. Non-interest expenses increased \$597,000 or 4.2% to \$14,922,000 for the nine months ended September 30, 2008 compared to \$14,325,000 for the nine months ended September 30, 2007.

The Company's efficiency ratio, measured as the percentage of non-interest expenses (exclusive of amortization of core deposit intangible assets) to net interest income before provision for credit losses plus non-interest income, was 69.2% for the first nine months of 2008 compared to 65.6% for the nine months ended September 30, 2007. The primary drivers for this change were the decreases in net interest income, increases in salaries and benefits expenses and occupancy expenses partially offset by the increased non-interest income.

Salaries and employee benefits increased \$388,000 or 4.8 % to \$8,491,000 for the first nine months of 2008 compared to \$8,103,000 for the nine months ended September 30, 2007. The increase in salaries and employee benefits for the 2008 period can be attributed to normal cost increases for salaries and benefits and an increase in the number of full time equivalent employees from 153 at September 30, 2007 to 159 at September 30, 2008. Commissions paid for loan placements are also in this category and decreased \$87,000 in the periods under review due to declining activity.

Occupancy and equipment expense increased \$41,000 or 2.1% to \$2,023,000 for the first nine months of 2008 compared to \$1,982,000 for the nine months ended September 30, 2008. Included in occupancy expense for the 2008 period was approximately \$35,000 related to the relocation of our Herndon and Fowler branch from an in-store location to a new traditional branch facility.



Table of Contents

Other non-interest expenses increased \$168,000 or 4.0% in the period under review. The following table shows significant components of other non-interest expense as a percentage of average assets.

For the nine months ended September 30, (Dollars in thousands) (Dollars in thousands)	Other Expense 2008	Annualized % Avg. Assets	Other Expense 2007	Annualized % Avg. Assets
Advertising	\$ 374	0.10%	\$ 368	0.10%
Audit/accounting	292	0.08%	235	0.07%
Data/item processing	614	0.16%	627	0.18%
ATM/debit card expenses	250	0.07%	238	0.07%
Director fees and related expenses	130	0.03%	130	0.04%
Donations	67	0.02%	81	0.02%
Education/training	90	0.02%	82	0.02%
General Insurance	97	0.03%	93	0.03%
Legal fees	102	0.03%	186	0.05%
Postage	130	0.03%	131	0.05%
Regulatory assessments	214	0.06%	82	0.02%
Stationery/supplies	162	0.04%	157	0.04%
Telephone	152	0.04%	142	0.04%
Operating losses	25	0.01%	25	0.01%
Other	1,709	0.45%	1,663	0.47%
Total other non-interest expense	\$ 4,408		\$ 4,240	

**Provision for Income Taxes**

The effective income tax rate was 32.3% for the nine months ended September 30, 2008 compared to 33.1% for the nine months ended September 30, 2007. Provision for income taxes totaled \$1,831,000 and \$2,302,000 for the nine months ended September 30, 2008, and 2007, respectively. The decrease in the effective tax rate in the nine months ended September 30, 2008 compared to the prior year comparable period is due primarily to an increase in the state tax deduction for loans and hiring credits generated in designated enterprise zones in California.

**Net Income for the Third Quarter of 2008 Compared to the Third Quarter of 2007:**

Net income was \$1,214,000 for the third quarter ended September 30, 2008 compared to \$1,576,000 for the third quarter ended September 30, 2007. Basic earnings per share were \$0.20 and \$0.26 for the quarters ended September 30, 2008 and 2007, respectively. Diluted earnings per share were \$0.19 and \$0.25 for the quarters ended September 30, 2008 and 2007, respectively. Annualized ROE was 8.82% for the quarter ended September 30, 2008 compared to 12.21% for the quarter ended September 30, 2007. Annualized ROA for the three months ended September 30, 2008 was 0.93% compared to 1.33% for the quarter ended September 30, 2007.

The decrease in net income for the quarter ended September 30, 2008 compared to the same period in the prior year was mainly due to the decrease in net interest income and an increase in the provision for loan credit losses and non-interest expenses, offset by an increase in non-interest income and a decrease in the provision for income taxes. Net interest income decreased due to a decrease in the yield on interest earning assets and an increase in the level of average interest-bearing liabilities, particularly other borrowed funds, partially offset by a lesser

## Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

decrease in our cost of interest-bearing liabilities and an increase in the level of our total average interest earning assets, particularly in loans, provided by our organic growth. The provision for credit losses increased as a result of the growth in loans and our ongoing assessment of the inherent risks and probable losses in our portfolio and the related required level of allowance for loan losses. Non interest revenues increased primarily from service charges and gains on sales of investment securities. Non-interest expenses increased primarily due to salaries and benefits, occupancy expenses and other expenses. The decrease in the provision for income taxes is reflective of the overall decrease in net income.

### **Interest Income and Expense**

The following table sets forth a summary of average balances with corresponding interest income and interest expense as well as average yield and cost information for the periods presented. Average balances are derived from daily balances, and non-accrual loans are not included as interest earning assets for purposes of this table.

Table of Contents

## CENTRAL VALLEY COMMUNITY BANCORP

## SCHEDULE OF AVERAGE BALANCES AND AVERAGE YIELDS AND RATES

(Dollars in thousands)

	FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008			FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2007		
	Average Balance	Interest Income/ Expense	Average Interest Rate	Average Balance	Interest Income/ Expense	Average Interest Rate
<b>ASSETS</b>						
Interest-earning deposits in other banks	\$ 4,674	\$ 35	2.97%	\$ 156	\$ 1	2.56%
Securities						
Taxable securities	77,705	1,174	6.04%	64,099	804	5.02%
Non-taxable securities (1)	23,960	339	5.67%	22,886	321	5.61%
Total investment securities	101,665	1,513	5.95%	86,985	1,125	5.17%
Federal funds sold	16,017	78	1.91%	8,578	109	5.08%
Total securities	122,356	1,626	5.32%	95,719	1,235	5.16%
Loans (2) (3)	351,239	6,165	6.96%	337,902	7,155	8.47%
Federal Home Loan Bank stock	2,095	32	6.11%	1,983	25	5.04%
<b>Total interest-earning assets</b>	<b>475,690</b>	<b>7,823</b>	<b>6.58%</b>	<b>435,604</b>	<b>8,415</b>	<b>7.73%</b>
Allowance for credit losses	(4,142)			(3,782)		
Non-accrual loans	1,382			27		
Cash and due from banks	18,930			16,461		
Bank premises & equipment	5,995			6,012		
Other non-earning assets	21,654			21,357		
<b>Total average assets</b>	<b>\$ 519,509</b>			<b>\$ 475,679</b>		
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>						
Interest-bearing liabilities:						
Savings and NOW accounts	\$ 73,514	65	0.35%	\$ 71,457	118	0.66%
Money market accounts	103,956	486	1.85%	97,531	668	2.74%
Time certificates of deposit, under \$100,000	62,022	466	2.98%	48,814	575	4.71%
Time certificates of deposit, \$100,000 and over	53,387	371	2.76%	64,252	704	4.38%
Total interest-bearing deposits	292,879	1,388	1.88%	282,054	2,065	2.93%
Other borrowed funds	38,900	265	2.70%	1,821	30	6.59%
<b>Total interest-bearing liabilities</b>	<b>331,779</b>	<b>1,653</b>	<b>1.98%</b>	<b>283,875</b>	<b>2,095</b>	<b>2.95%</b>
Non-interest bearing demand deposits	127,217			135,054		
Other liabilities	5,453			5,124		
Shareholders equity	55,060			51,626		
Total average liabilities and shareholders equity	\$ 519,509			\$ 475,679		
Interest income and rate earned on average earning assets		7,823	6.58%		8,415	7.73%
Interest expense and interest cost related to average interest-bearing liabilities		1,653	1.98%		2,095	2.95%
<b>Net interest income and net interest margin (4)</b>		<b>\$ 6,170</b>	<b>5.19%</b>		<b>\$ 6,320</b>	<b>5.80%</b>

(1)

## Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

Calculated on a fully tax equivalent basis, which includes Federal tax benefits relating to income earned on municipal bonds totaling \$115 and \$109 in 2008 and 2007, respectively.

- (2) Loan interest income includes net loan fees of \$165 in 2008 and \$192 in 2007.
- (3) Average loans do not include non-accrual loans.
- (4) Net interest margin is computed by dividing net interest income by total average interest-earning assets.

Table of Contents

Interest and fee income from loans decreased \$990,000 or 13.8% to \$6,165,000 for the third quarter of 2008 compared to \$7,155,000 for the same period in 2007. Average total loans for the third quarter of 2008 increased 4.3% to \$352,621,000 compared to \$337,929,000 for the same period in 2007, while the yield on loans decreased by 151 basis points. The decrease in loan yield is primarily due to the 325 basis points decline in interest rates by the Federal Reserve Bank since September 2007 coupled with the competitive loan environment in the Central Valley. Our loan yield for the third quarter of 2008 was 6.96% compared to 8.47% for the same period in 2007.

Interest income from total investments (total investments include investment securities, Federal funds sold, interest bearing deposits with other banks, and other securities) increased \$385,000 in the third quarter of 2008 compared to the same period in 2007, mainly due to an increase in the average investment balance for the third quarter of 2008 compared to the same period in 2007 and an overall increase in the yields earned. The average balance of investments increased \$26,637,000 or 27.8% to \$122,356,000 for the third quarter of 2008 from \$95,719,000 for the comparable 2007 period. The yield on total investments for the quarter ended September 30, 2008 was 5.32% compared to 5.16% for the quarter ended September 30, 2007. Income from investments represents 25.1% of net interest income for the third quarter of 2008 compared to 18.2% for the same quarter in 2007.

Total interest income for the third quarter of 2008 decreased \$605,000, to \$7,676,000 compared to \$8,281,000 for the quarter ended September 30, 2007. The decrease was due to the 115 basis point decrease in the yield on total interest earning assets, offset by the 9.2% increase in the average balance of those assets. The yield on interest earning assets decreased to 6.58% for the quarter ended September 30, 2008 compared to 7.73% for the quarter ended September 30, 2007. Average interest earning assets increased to \$475,690,000 for the quarter ended September 30, 2008 compared to \$435,604,000 for the quarter ended September 30, 2007. The \$40,086,000 increase in average earning assets can be attributed to our own organic growth and to a leverage strategy employed in first quarter of 2008 whereby we purchased investment securities funded by FHLB borrowings.

Interest expense on deposits for the quarter ended September 30, 2008 decreased \$677,000 or 32.8% to \$1,388,000 compared to \$2,065,000 for the quarter ended September 30, 2007. The cost of deposits, calculated by dividing annualized interest expense on interest bearing deposits by total deposits, decreased 65 basis points to 1.31% for the quarter ended September 30, 2008 compared to 1.96% for the same period in 2007. This decrease was due to the repricing of interest bearing deposits in the lower current interest rate environment. Over the same period, average interest bearing deposits increased 3.8% or \$10,825,000. Average interest-bearing deposits were \$292,879,000 for the quarter ended September 30, 2008, with an effective rate paid of 1.88%, compared to \$282,054,000 for the same period in 2007, with an effective rate paid of 2.93%.

Average other borrowed funds increased \$37,079,000 to \$38,900,000 with an effective rate of 2.70% for the quarter ended September 30, 2008 compared to \$1,821,000 with an effective rate of 6.59% for the quarter ended September 30, 2007. As a result of the significant increase in the average balances having a greater impact than the significant decrease in the rates paid, interest expense on other borrowed funds increased \$235,000 to \$265,000 for the quarter ended September 30, 2008 from \$30,000 for the quarter ended September 30, 2007. Other borrowings are advances from the FHLB. The FHLB advances are fixed rate, secured, short-term and long term borrowings. Short-term advances were utilized to provide liquidity during the period and long-term advances were utilized as part of a leveraged strategy in the first quarter of 2008 to purchase investment securities.

The cost of all of our interest bearing liabilities decreased 97 basis points to 1.98% for the quarter ended September 30, 2008 compared to 2.95% for the quarter ended September 30, 2007. The decrease is due to the lower current interest rate environment as mentioned above. Additionally, non-interest bearing demand deposits decreased in the periods under review. Average non-interest bearing demand deposits decreased 5.8% to \$127,217,000 for the quarter ended September 30, 2008 from \$135,054,000 for the quarter ended September 30, 2007. Average transaction accounts (including interest bearing checking, money market accounts and non-interest bearing demand deposits) increased 1.2% to \$286,653,000 for the quarter ended September 30, 2008 compared to \$283,283,000 for the quarter ended September 30, 2007. Average time

## Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

certificates of deposit increased \$2,343,000 or 2.1% to \$115,409,000 for the quarter ended September 30, 2008 compared to \$113,066,000 for the quarter ended September 30, 2007.

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

Net interest income before provision for credit losses for the quarter ended September 30, 2008 decreased \$163,000 or 2.6% to \$6,023,000 compared to \$6,186,000 for the quarter ended September 30, 2007. This decrease was primarily due to an increase in average interest-bearing liabilities and a decrease in the net interest margin of 61 basis points, partially offset by an increase in average interest earning assets. Average interest earning assets were \$475,690,000 for the quarter ended September 30, 2008 and the net interest margin was 5.19% compared to \$435,604,000 and a net interest margin of 5.80% for the quarter ended September 30, 2007. For a discussion of the repricing of our assets and liabilities, see Item 3 - Quantitative and Qualitative Disclosure about Market Risk.

## **Table of Contents**

### **Provision for Credit Losses**

Additions to the allowance for credit losses in the third quarter of 2008 were \$635,000 compared to \$120,000 for the third quarter of 2007. The increase in 2008 is principally due to the increase in the volume of outstanding loans and our assessment of the inherent risks and probable losses in determining the overall adequacy of the allowance for credit losses.

The Company had non-performing loans totaling \$1,419,000 as of September 30, 2008 compared to \$179,000 as of December 31, 2007 and \$11,000 as of September 30, 2007. The Company did not have any other real estate owned at September 30, 2008, December 31, 2007 or September 30, 2007.

The Company had \$178,000 net loan charge-offs for the third quarter of 2008 compared to \$33,000 for the same quarter in 2007. The net charge-off ratio, which reflects net charge-offs to average loans, was 0.05% for the quarter ended September 30, 2008 compared to 0.001% for the quarter ended September 30, 2007. Refer to the allowance for credit losses section for further discussion of credit quality.

### **Non-Interest Income**

Non-interest income is comprised primarily of customer service charges, loan placement fees and other service fees, gains on sales of investment securities, appreciation in cash surrender value of bank owned life insurance, FHLB stock dividends, and other income. Non-interest income was \$1,382,000 for the quarter ended September 30, 2008 compared to \$1,075,000 for the same period ended September 30, 2007. The \$307,000 increase in non-interest income comparing the quarter ended September 30, 2008 to the same period in 2007 was primarily due to increases in service charges and net realized gains on sales of investment securities.

Customer service charges increased \$120,000 to \$827,000 for the third quarter of 2008 compared to \$707,000 for the same period in 2007 due primarily to an increase in analysis service charges on business checking accounts and overdraft fees on consumer checking accounts.

Net realized gains on investment securities increased to \$156,000 for the third quarter of 2008 compared to none for the same period in 2007. In the third quarter we sold certain investments with a book value of \$10,626,000 and purchased \$13,620,000 in new securities to reposition the portfolio in an effort to increase yield. Other income increased \$31,000 to \$284,000 for the third quarter of 2008 compared to \$253,000 for the same period in 2007, primarily due to increases in electronic funds transfer fees and in merchant card fee income.

### **Non-Interest Expenses**

Salaries and employee benefits, occupancy, professional services, and data processing are the major categories of non-interest expenses. Non-interest expenses increased \$120,000 to \$4,984,000 for the quarter ended September 30, 2008 compared to \$4,864,000 for the same period

in 2007.

The Company's efficiency ratio, measured as the percentage of non-interest expenses (exclusive of amortization of core deposit intangible assets) to net interest income before provision for credit losses plus non-interest income (excluding net gains from sales of securities and assets), was 69.2% for the third quarter of 2008 compared to 65.6% for the third quarter of 2007.

Salaries and employee benefits increased \$44,000 or 1.6% to \$2,775,000 for the third quarter of 2008 compared to \$2,731,000 for the third quarter of 2007. The increase in salaries and employee benefits for the third quarter of 2008 can be attributed to an increase in the number of employees and normal cost increases for salaries and benefits.

Occupancy and equipment expense increased \$38,000 to \$713,000 for the third quarter of 2008 compared to \$675,000 for the third quarter of 2007. The 5.6% increase in occupancy expense for the quarter ended September 30, 2008 was due mainly to normal increases in rent on existing leaseholds, and other occupancy and equipment related expenses mainly associated with relocating our Herndon and Fowler branch from an in-store location to a new traditional branch facility.

Other non-interest expenses increased \$38,000 or 2.6% in the period under review. The increase can be attributed in part to expenses associated with an increase in regulatory assessments as well as expenses for the move of our Herndon and Fowler in-store branch office to a traditional branch facility.

#### **Provision for Income Taxes**

The effective income tax rate was 32.0% for the third quarter of 2008 compared to 30.8% for the same period in 2007. Provision for income taxes totaled \$572,000 and \$701,000 for the quarters ended September 30, 2008, and 2007, respectively. The increase in the effective tax rate in the three months ended September 30, 2008 compared to the prior year comparable period is due primarily to a decrease in enterprise zone net interest deduction for state tax.



Table of Contents**FINANCIAL CONDITION****Summary of Changes in Consolidated Balance Sheets**

September 30, 2008 compared to December 31, 2007

As of September 30, 2008, total assets were \$524,636,000, an increase of 8.5%, or \$40,951,000, compared to \$483,685,000 as of December 31, 2007. Total gross loans increased 3.7% or \$12,750,000, to \$353,878,000 as of September 30, 2008 compared to \$341,128,000 as of December 31, 2007. Total deposits increased 4.9% or \$19,624,000 to \$422,186,000 as of September 30, 2008 compared to \$402,562,000 as of December 31, 2007. Total borrowings increased 94.5% or \$18,900,000 to \$38,900,000 as of September 30, 2008 compared to \$20,000,000 as of December 31, 2007. Stockholders' equity increased to \$55,106,000 as of September 30, 2008 compared to \$54,194,000 as of December 31, 2007.

**Investments**

Our investment portfolio consists primarily of agency securities, mortgage backed securities, municipal securities, and overnight investments in the Federal Funds market and are classified, at the time of purchase, as available-for-sale or held-to-maturity. As of September 30, 2008, \$77,052,000 was held as collateral for public funds, treasury, tax, and for other purposes. Our investment policies are established by the Board of Directors and implemented by our Investment/Asset Liability Committee. It is designed primarily to provide and maintain liquidity, to enable us to meet our pledging requirements for public money and borrowing arrangements, to generate a favorable return on investments without incurring undue interest rate and credit risk, and to complement our lending activities.

The level of our investment securities, as described in the table below, is generally considered higher than our peers due mostly to our relatively low loan to deposit ratio. The amortized cost of these investment securities increased 21.0% from \$84,139,000 at December 31, 2007 to \$101,841,000 at September 30, 2008. The fair value of the portfolio reflected net unrealized loss of \$4,221,000 at September 30, 2008 compared to an unrealized gain of \$234,000 at December 31, 2007.

The following table sets forth the carrying values and estimated fair values of our investment securities portfolio at the dates indicated:

September 30, 2008	Amortized	Gross	Gross	Market
Available-for-Sale Securities	Cost	Unrealized	Unrealized	Value
		Gains	(Losses)	
Obligations of states and political subdivisions	\$ 22,548	\$ 201	\$ (551)	\$ 22,198
U.S. Government agencies collateralized by mortgage obligations	22,838	168	(73)	22,933
	45,118	1,059	(4,609)	41,568

Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

Other securities collateralized by mortgage obligations						
Other securities		3,884		(50)	3,834	
	\$	94,388	\$	1,428	\$ (5,283) \$	90,533

September 30, 2008 Held-to-Maturity Securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Market Value
Other securities collateralized by mortgage obligations	\$ 7,453	\$	\$ (366)	\$ 7,087

December 31, 2007 Available-for-Sale Securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Market Value
U.S. Government agencies	\$ 8,496	\$ 4	\$ (10)	\$ 8,490
Obligations of states and political subdivisions	25,736	323	(77)	25,982
U.S. Government agencies collateralized by mortgage obligations	33,670	206	(109)	33,767
Other securities collateralized by mortgage obligations	12,418	69	(130)	12,357
Other securities	3,819		(42)	3,777
	\$ 84,139	\$ 602	\$ (368)	\$ 84,373

# Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

## Table of Contents

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

The net unrealized loss for mark to market in the portfolio was \$4,221,000 at September 30, 2008 compared to an unrealized gain of \$234,000 as of December 31, 2007. The change in the market value primarily relates to the illiquidity of certain mortgage backed securities due to the current real estate mortgage environment and changes in interest rates.

We held \$2,110,000 in Federal Home Loan Bank stock as of September 30, 2008 compared to \$2,022,000 as of December 31, 2007. The increase is the result of stock dividends received.

## Loans

Total gross loans increased 3.7% or \$12,750,000, to \$353,878,000 as of September 30, 2008 compared to \$341,128,000 as of December 31, 2007. The following table sets forth information concerning the composition of our loan portfolio at the dates indicated:

CHECK ALIGNMENT OF THE AMOUNTS IN THE COLUMNS IN THIS TABLE.

Loan Type (Dollars in thousands)	September 30, 2008	% of Total loans	December 31, 2007	% of Total loans
<b>Commercial:</b>				
Commercial and industrial	\$ 102,177	28.8%	\$ 92,613	27.1%
Agricultural land and production	28,365	8.0%	32,167	9.4%
Total commercial	130,542	36.8%	124,780	36.5%
<b>Real estate:</b>				
Owner occupied	83,515	23.6%	76,808	22.4%
Real estate-construction and other land loan	37,598	10.6%	48,593	14.2%
Commercial real estate	41,305	11.7%	43,334	12.8%
Other	27,922	7.9%	17,406	5.1%
Total real estate	190,340	53.8%	186,141	54.5%
<b>Consumer:</b>				
Equity loans and lines of credit	27,162	7.7%	24,595	7.2%
Consumer and installment	5,817	1.6%	5,742	1.7%
Other	537	0.1%	458	0.1%
Total consumer	33,516	9.4%	30,795	9.0%
Deferred loan fees, net	(520)		(588)	

Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

Total gross loans	353,878	100.0%	341,128	100.0%
Allowance for credit losses	(4,533)		(3,887)	
Total loans	\$ 349,345	\$	337,241	

As of September 30, 2008, a concentration of loans existed in loans collateralized by real estate (real estate, real estate construction, land development and other land loans, and equity lines of credit) comprising 61.5% of total loans. This level of concentration is consistent with 61.8% at December 31, 2007. Although management believes the loans within this concentration have no more than the normal risk of collectibility, a substantial decline in the performance of the economy in general or a decline in real estate values in the our primary market areas, in particular, could have an adverse impact on collectibility, increase the level of real estate-related non-performing loans, or have other adverse effects which alone or in the aggregate could have a material adverse effect on our business, financial condition, results of operations and cash flows. The Company is not involved in any sub-prime mortgage lending activities and the loan portfolio does not include any sub prime mortgage loans at September 30, 2008 or December 31, 2007.

Table of Contents

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

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

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

At September 30, 2008 and December 31, 2007, we had no OREO or repossessed assets. At September 30, 2008 we had non-accrual loans totaling \$1,419,000 compared to \$179,000 at December 31, 2007. Included in non-accrual loans was one restructured loan totaling \$1,107,000. We measure our impaired loans by using the fair value of the collateral if the loan is collateral-dependent and the present value of the expected future cash flows discounted at the loan's effective interest rate if the loan is not collateral-dependent. At September 30, 2008, we estimated that the potential for any losses from these credits would not have a significant impact on the allowance for credit losses. Based on our valuation and the government guarantees on these loans, we have not established any specific reserves for these loans.

A summary of non-accrual, non-performing and past due loans at September 30, 2008 and December 31, 2007 is set forth below. The Company had no accruing loans past due more than 90 days at September 30, 2008 and December 31, 2007. Management can give no assurance that non-accrual and other non-performing loans will not increase in the future.

**Composition of Non-accrual, Past Due and Restructured Loans**

(Dollars in thousands)	September 30, 2008	December 31, 2007
<b>Non-accrual Loans</b>		
Commercial and industrial loans	\$ 312	\$ 100
Real Estate	1,107	79
Total non-accrual	1,419	179
<b>Accruing loans past due 90 days or more</b>		
Total non-performing loans	\$ 1,419	\$ 179
Nonperforming loans to total loans	0.40%	0.05%
Ratio of non-performing loans to allowance for credit losses	31.30%	4.61%

Loans considered to be impaired	\$	1,419	\$	179
Related allowance for credit losses on impaired loans	\$		\$	

**Classified Assets.** From time to time, management has reason to believe that certain borrowers may not be able to repay their loans within the parameters of the present repayment terms, even though, in some cases, the loans are current at the time. These loans are graded in the classified loan grades of substandard, doubtful, or loss and include non-performing loans. Each classified loan is monitored monthly.

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

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

Table of Contents

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

The allowance for credit losses is an estimate of the losses that may be sustained in our loan and lease portfolio. The allowance is based on two principles of accounting: (1) Statement of Financial Accounting Standards (SFAS) No. 5, Accounting for Contingencies, which requires that losses be accrued when they are probable of occurring and estimable; and (2) SFAS No. 114, Accounting by Creditors for Impairment of a Loan and SFAS No. 118, Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures, which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

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

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

(Dollars in thousands)	For the Nine Month Period Ended September 30, 2008	For the Year Ended December 31, 2007
Balance, beginning of the year	\$ 3,887	\$ 3,809
Provision charged to operations	905	480
Losses charged to allowance	(324)	(481)
Recoveries	65	79
Balance, end of period	\$ 4,533	\$ 3,887
Ratio of non-performing loans to allowance for credit losses	31.30%	4.61%
Allowance for credit losses to total loans	1.28%	1.14%

As of September 30, 2008 the balance in the allowance for credit losses was \$4,533,000 compared to \$3,887,000 as of December 31, 2007. The increase was due to net charge offs during the first three quarters of 2008 being less than the amount of the provision for credit losses. Net charge offs totaled \$259,000 while the provision for credit losses was \$905,000.

The balance of commitments to extend credit on undisbursed construction and other loans and letters of credit was \$121,573,000 as of September 30, 2008 compared to \$135,638,000 as of December 31, 2007. Risks and uncertainties exist in all lending transactions, and even though there have historically been no charge offs on construction and other loans that have not been fully disbursed, our management and

## Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

Directors Loan Committee have established reserve levels based on historical losses as well as economic uncertainties and other risks that exist as of each reporting period.

As of September 30, 2008 the allowance was 1.28% of total gross loans compared to 1.14% as of December 31, 2007. During the nine months ended September 30, 2008, there were no major changes in loan concentrations that significantly affected the allowance for credit losses. There have been no significant changes in estimation methods during the periods presented. Assumptions regarding the collateral value of various under performing loans may affect the level and allocation of the allowance for credit losses in future periods. The allowance may also be affected by trends in the amount of charge offs experienced or expected trends within different loan portfolios. Management believes the allowance at September 30, 2008 is adequate based upon its ongoing analysis of the loan portfolio, historical loss trends and other factors. However, no assurance can be given that the Company may not sustain charge-offs which are in excess of the allowance in any given period.



**Table of Contents****Deposits and Borrowings**

Total deposits increased \$19,624,000 or 4.9% to \$422,186,000 as of September 30, 2008 compared to \$402,562,000 as of December 31, 2007. Interest bearing deposits increased \$21,681,000 or 7.9% to \$296,123,000 as of September 30, 2008 compared to \$274,442,000 as of December 31, 2007. Non-interest bearing deposits decreased \$2,057,000 or 1.6% to \$126,063,000 as of September 30, 2008 compared to \$128,120,000 as of December 31, 2007. Interest bearing deposits include \$5,000,000 in callable brokered CDs, the proceeds from which were used to purchase investment securities.

By expanding our branching network we anticipate broadening our deposit gathering base. We relocated our Kerman branch to a larger facility the first quarter of 2007 and relocated our Clovis in-store branch to a larger stand alone facility in the second quarter of 2008.

The composition of the deposits and average interest rates paid at September 30, 2008 and December 31, 2007 is summarized in the table below.

(Dollars in thousands)	September 30, 2008	% of Total Deposits	Effective Rate	December 31, 2007	% of Total Deposits	Effective Rate
NOW accounts	\$ 57,315	13.6%	0.34%	\$ 53,114	13.2%	0.66%
MMA accounts	102,377	24.2%	2.12%	90,402	22.5%	2.64%
Time deposits	118,753	28.1%	3.68%	111,628	27.7%	4.39%
Savings deposits	17,678	4.2%	0.35%	19,298	4.8%	0.48%
Total interest-bearing	296,123	70.1%	2.29%	274,442	68.2%	2.79%
Non-interest bearing	126,063	29.9%		128,120	31.8%	
Total deposits	\$ 422,186	100.0%		\$ 402,562	100.0%	

Short-term borrowings totaled \$19,900,000 as of September 30, 2008 compared to \$20,000,000 as of December 31, 2007. Short-term borrowings at September 30, 2008, represent FHLB advances with weighted average interest rates of 2.26% and coming due within the fourth quarter of 2008. We maintain a line of credit with the FHLB collateralized by government securities. Refer to Liquidity below for further discussion of FHLB advances.

Long-term borrowings of \$19,000,000 at September 30, 2008 represent FHLB advances with weighted average interest of 3.08% and weighted average maturity of 2.6 years. There were no long-term borrowings at December 31, 2007. During the first quarter of 2008, the Bank utilized a leveraged strategy and borrowed from the FHLB to fund investments with similar maturities.

**Capital**

Our stockholders' equity was \$55,106,000 as of September 30, 2008 compared to \$54,194,000 as of December 31, 2007. The increase in stockholders' equity is a result of net income of \$3,834,000 combined with the proceeds from the exercise of stock options of \$207,000 and the

## Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

effect of stock-based compensation expense of \$181,000 partially offset by payment of cash dividends of \$598,000, a \$316,000 reduction as a cumulative-effect adjustment related to adoption of the provisions relating to split-dollar life insurance policies and a \$2,453,000 increase in the unrealized loss on available for sale investment securities for the nine months ended September 30, 2008.

On February 20, 2008, the Board of Directors of Central Valley Community Bancorp declared a \$0.10 per share cash dividend for shareholders of record as of March 11, 2008, payable on March 31, 2008.

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

# Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

## Table of Contents

The following table presents the Company's and the Bank's capital ratios as of September 30, 2008 and December 31, 2007.

(Dollars in thousands)	September 30, 2008		December 31, 2007	
	Amount	Ratio	Amount	Ratio
<b><u>Tier 1 Leverage Ratio</u></b>				
Central Valley Community Bancorp and Subsidiary	\$ 47,758	9.37%	\$ 44,238	9.43%
Minimum regulatory requirement	\$ 20,395	4.00%	\$ 18,758	4.00%
Central Valley Community Bank	\$ 45,460	8.93%	\$ 42,202	9.00%
Minimum requirement for Well-Capitalized institution	\$ 25,448	5.00%	\$ 23,438	5.00%
Minimum regulatory requirement	\$ 20,358	4.00%	\$ 18,751	4.00%
<b><u>Tier 1 Risk-Based Capital Ratio</u></b>				
Central Valley Community Bancorp and Subsidiary	\$ 47,758	11.60%	\$ 44,238	11.65%
Minimum regulatory requirement	\$ 16,469	4.00%	\$ 15,188	4.00%
Central Valley Community Bank	\$ 45,460	11.06%	\$ 42,202	11.12%
Minimum requirement for Well-Capitalized institution	\$ 24,666	6.00%	\$ 22,773	6.00%
Minimum regulatory requirement	\$ 16,444	4.00%	\$ 15,182	4.00%
<b><u>Total Risk-Based Capital Ratio</u></b>				
Central Valley Community Bancorp and Subsidiary	\$ 52,291	12.70%	\$ 48,125	12.67%
Minimum regulatory requirement	\$ 32,937	8.00%	\$ 30,376	8.00%
Central Valley Community Bank	\$ 49,993	12.16%	\$ 46,089	12.14%
Minimum requirement for Well-Capitalized institution	\$ 41,111	10.00%	\$ 37,954	10.00%
Minimum regulatory requirement	\$ 32,889	8.00%	\$ 30,363	8.00%

On October 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008 (the "EESA"). Pursuant to the EESA, the Secretary of the Treasury was authorized to establish the Troubled Asset Relief Program ("TARP") and to invest in financial institutions and purchase mortgages, mortgage-backed securities and certain other financial instruments from financial institutions, in an aggregate amount up to \$700 billion, for the purpose of stabilizing and providing liquidity to the U.S. financial markets. On October 14, 2008, the United States Department of the Treasury (the "UST") announced a Capital Purchase Program ("CPP") to invest up to \$250 billion of this \$700 billion amount in certain eligible U.S. banks, thrifts and their holding companies in the form of non-voting, senior preferred stock. Bank holding companies and banks eligible to participate as a Qualifying Financial Institution ("QFI") in the CPP will be expected to comply with certain standardized terms and conditions specified by the UST, including the following:

- Submission of an application prior to November 14, 2008 to the QFI's Federal banking regulator to obtain preliminary approval to participate in the CPP;
- If the QFI receives preliminary approval, it will have 30 days within which to submit final documentation and fulfill any outstanding requirements;
- The minimum amount of capital eligible for purchase by the UST under the CPP is 1 percent of the Total Risk-Weighted Assets of the QFI and the maximum is the lesser of (i) an amount equal to 3 percent of the Total Risk-Weighted Assets of the QFI or (ii) \$25 billion;
- Capital acquired by a QFI under the CPP will be accorded Tier 1 capital treatment;
- The preferred stock issued to the UST will be non-voting (except in the case of class votes), senior perpetual preferred stock that ranks senior to common stock and pari passu with existing preferred stock (except junior preferred stock);

## Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

- In addition to the preferred stock, the UST will be issued warrants to acquire shares of the QFI's common stock equal in value to 15 percent of the amount of capital purchased by the UST;
- Dividends on the preferred stock are payable to the UST at the rate of 5% per annum for the first 5 years and 9% per annum thereafter;
- Subject to certain exceptions and other requirements, no redemption of the preferred stock is permitted during the first 3 years;
- Certain restrictions on the payment of dividends to shareholders of the QFI shall remain in effect while the preferred stock purchased by the UST is outstanding;
- Any repurchase of QFI shares will require the consent of the UST, subject to certain exceptions;
- The preferred shares are not subject to any contractual restrictions on transfer; and
- The QFI must agree to be bound by certain executive compensation and corporate governance requirements and senior executive officers must agree to certain compensation restrictions.

Table of Contents

The Company and the Bank meet all of their capital requirements and the Bank is considered well capitalized. The Company's capital position and other liquidity sources provide deposit customers with an important level of safety and confidence in the Company that is essential in these uncertain economic times. Management is currently researching the CPP Program and evaluating its options.

**Liquidity**

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

Our primary sources of liquidity are derived from financing activities which include the acceptance of customer and, to a lesser extent, broker deposits, federal funds facilities and advances from the Federal Home Loan Bank of San Francisco. These funding sources are augmented by payments of principal and interest on loans, the routine maturities and pay downs of securities from the securities portfolio, the stability of our core deposits and the ability to sell investment securities. Primary uses of funds include withdrawal of and interest payments on deposits, originations and purchases of loans, purchases of investment securities, and payment of operating expenses.

As a means of augmenting our liquidity, we have established federal funds lines with correspondent banks. At September 30, 2008 our available borrowing capacity includes approximately \$24,000,000 in Federal funds lines with our correspondent banks and \$6,527,000 in unused FHLB advances. We believe our liquidity sources to be stable and adequate. At September 30, 2008, we were not aware of any information that was reasonably likely to have a material effect on our liquidity position.

The following table reflects the Company's credit lines, balances outstanding, and pledged collateral at September 30, 2008 and December 31, 2007:

Credit Lines (In thousands)	September 30, 2008	December 31, 2007
<b>Unsecured Credit Lines (interest rate varies with market):</b>		
Credit limit	\$ 24,000	\$ 18,000
Balance outstanding	\$	\$
<b>Federal Home Loan Bank (interest rate at prevailing interest rate):</b>		
Credit limit	\$ 45,427	\$ 23,498
Balance outstanding	\$ 38,900	\$ 20,000
Collateral pledged	\$ 60,305	\$ 24,231
Fair value of collateral	\$ 57,225	\$ 24,203
<b>Federal Reserve Bank (interest rate at prevailing discount interest rate):</b>		
Credit limit	\$ 1,935	\$ 1,986
Balance outstanding	\$	\$
Collateral pledged	\$ 1,963	\$ 2,032
Fair value of collateral	\$ 1,922	\$ 2,057

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

Table of Contents

**OFF-BALANCE SHEET ITEMS**

In the ordinary course of business, the Company is a party to financial instruments with off-balance risk. These financial instruments include commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received. For a fuller discussion of these financial instruments, refer to Note 5 Commitments and Contingencies of the Company's condensed consolidated financial statements included herein and Note 8 Commitments and Contingencies in the Company's 2007 Annual Report to Shareholders on Form 10-K.

In the ordinary course of business, the Company is party to various operating leases. For a fuller discussion of these financial instruments, refer to Note 8 Commitments and Contingencies in the Company's 2007 Annual Report to Shareholders on Form 10-K.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

We realize income principally from the differential or spread between the interest earned on loans, investments, other interest-earning assets and the interest incurred on deposits and borrowings. The volumes and yields on loans, deposits and borrowings are affected by market interest rates. As of September 30, 2008, approximately 83.5% of our loan portfolio was tied to adjustable rate indices. Of these adjustable rate loans, 46.9% are tied to prime and reprice within 90 days. The majority of our time deposits have a fixed rate of interest. As of September 30, 2008, 86.5% of our time deposits mature within one year or less. As of September 30, 2008, \$19,900,000 of our short-term debt reprices within two months.

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

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

The ALCO seeks to stabilize our NII by matching rate-sensitive assets and liabilities through maintaining the maturity and repricing of these assets and liabilities at appropriate levels given the interest rate environment. When the amount of rate-sensitive liabilities exceeds rate-sensitive assets within specified time periods, NII generally will be negatively impacted by an increasing interest rate environment and positively impacted by a decreasing interest rate environment. Conversely, when the amount of rate-sensitive assets exceeds the amount of rate-sensitive liabilities within specified time periods, net interest income will generally be positively impacted by an increasing interest rate environment and

## Edgar Filing: CENTRAL VALLEY COMMUNITY BANCORP - Form 10-Q

negatively impacted by a decreasing interest rate environment. The speed and velocity of the repricing of assets and liabilities will also contribute to the effects on our NII, as will the presence or absence of periodic and lifetime interest rate caps and floors.

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

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

Approximately 83.5% of our loan portfolio is tied to adjustable rate indices and 46.9% of our loan portfolio reprices within 90 days. As of September 30, 2008, we had 113 loans totaling \$59,186,000 with floors ranging from 4% to 8% and ceilings ranging from 8% to 25%. In the current rate environment, the number of loans affected by floors and ceilings is minimal.

The following table shows the effects of changes in projected net interest income for the twelve months ending September 30, 2009 under the interest rate shock scenarios stated. The table was prepared as of September 30, 2008, at which time prime interest rate was 5.00%. The amounts identified in the table are not materially different from what we showed at December 31, 2007.



Table of Contents

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

Hypothetical Change in Rates	Projected Net Interest Income (\$000)	Change from Rates at September 30, 2008 (\$000)	Percent Change from Rates at September 30, 2008
UP 200 bp	\$ 25,641	\$ 732	2.94%
UP 100 bp	25,273	364	1.46%
UNCHANGED	24,909		
DOWN 100 bp	24,341	(568)	(2.28)%
DOWN 150 bp	23,713	(1,196)	(4.80)%

Assumptions are inherently uncertain, and, consequently, the model cannot precisely measure net interest income or precisely predict the impact of changes in interest rates on net interest income. Actual results will differ from simulated results due to timing, magnitude and frequency of interest rate changes, as well as changes in market conditions and management strategies which might moderate the negative consequences of interest rate deviations. In the model above, the simulation shows that the Company is neutral over the one-year horizon. If interest rates increase or decline, there will be similar positive and negative impact to net interest income.

**ITEM 4. CONTROLS AND PROCEDURES**

As of the end of the period covered by this report, management, including the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures with respect to the information generated for use in this Quarterly Report. The evaluation was based in part upon reports provided by a number of executives. Based upon, and as of the date of that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures, as so amended, were effective to provide reasonable assurances that information required to be disclosed in the reports the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that information required to be disclosed by the Company in the reports that it files or submits is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure.

There was no change in the Company's internal controls over financial reporting during the quarter ended September 30, 2008 that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

In designing and evaluating disclosure controls and procedures, the Company's management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable, not absolute, assurances of achieving the desired control objectives and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

**PART II OTHER INFORMATION****ITEM 1 LEGAL PROCEEDINGS**

None to report.

#### **ITEM 1A RISK FACTORS**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2007, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

While not a specific risk factor for the Company, the overall decline in residential real estate values in California, and more specifically in our primary market, has continued into 2008. While the Company has not been materially impacted by this trend to the level of some other financial institutions, continuing declines in residential real estate may have a continuing negative impact on the overall economic conditions in the Company's markets and may result in increased credit losses and/or reduced opportunities for future growth thereby adversely affecting the Company's results of operations and financial condition.

Table of Contents

**ITEM 2 CHANGES IN SECURITIES AND USE OF PROCEEDS**

None to report.

On November 20, 2007, the Board of Directors approved a stock repurchase plan authorizing the purchase of shares of the Company's common stock up to a total cost of approximately \$1,000,000 during the period from November 21, 2007 to May 21, 2008. Under the plan, the Company repurchased 24,300 shares in 2007 at an average price of \$12.55 for a total cost of \$305,000. During the quarter ended September 30, 2008, the Company did not repurchase any shares. The plan expired May 20, 2008.

**ITEM 3 DEFAULTS UPON SENIOR SECURITIES**

None to report.

**ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

a. The Company held a specially called shareholders meeting on October 10, 2008.

c. At the meeting the shareholders approved the merger of the Company with Service 1<sup>st</sup> Bancorp by the following vote:

Votes for: 4,663,924    Votes against: 27,373    Abstentions: 18,636

**ITEM 5 OTHER INFORMATION<sup>1</sup>**

None to report.

**ITEM 6 EXHIBITS**

(a) Exhibits

<b>Exhibit No.</b>	<b>Description</b>
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Table of Contents

**SIGNATURES**

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

Central Valley Community Bancorp

Date: November 12, 2008

/s/ Daniel J. Doyle  
Daniel J. Doyle  
President and Chief Executive Officer

Date: November 12, 2008

/s/ David A. Kinross  
David A. Kinross  
Senior Vice President and Chief Financial Officer

Table of Contents

**EXHIBIT INDEX**

- 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002