TRICO BANCSHARES /
Form 10-K
March 07, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-K

Annual Report

Pursuant to Section 13 or 15(d) of

the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2013	**Commission File Number 0-10661**

TriCo Bancshares

(Exact name of Registrant as specified in its charter)

California	**94-2792841**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

63 Constitution Drive, Chico, California	**95973**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code:(530) 898-0300

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

Common Stock, without par value	**Nasdaq Stock Market LLC**
(Title of Class)	**(Name of each exchange on which registered)**

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

Indicate by check mark whether the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ¨ NO x

Indicate by check mark whether the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ¨ NO x

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-K or any amendment to this Form 10-K. YES x 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 Act (check one).

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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO x

The aggregate market value of the voting common stock held by non-affiliates of the Registrant, as of June 30, 2013, was approximately $262,109,000 (based on the closing sales price of the Registrant s common stock on the date). This computation excludes a total of 3,777,212 shares that are beneficially owned by the officers and directors of Registrant who may be deemed to be the affiliates of Registrant under applicable rules of the Securities and Exchange Commission.

The number of shares outstanding of Registrant s common stock, as of February 28, 2014, was 16,107,242 shares of common stock, without par value.

DOCUMENTS INCORPORATED BY REFERENCE

The information required to be disclosed pursuant to Part III of this report either shall be (i) deemed to be incorporated by reference from selected portions of TriCo Bancshares definitive proxy statement for the 2014 annual meeting of stockholders, if such proxy statement is filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the Company s most recently completed fiscal year, or (ii) included in an amendment to this report filed with the Commission on Form 10-K/A not later than the end of such 120 day period.

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FORWARD-LOOKING STATEMENTS

In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements about TriCo Bancshares (the Company, TriCo or we) and its subsidiaries for which it claims the protection of the safe harbor provisions contained in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on Management s current knowledge and belief and include information concerning the Company s possible or assumed future financial condition and results of operations. When you see any of the words believes , expects , anticipates , estimates , or similar expressions, these generally indicate that we are making forward-looking statements. A number of factors, some of which are beyond the Company s ability to predict or control, could cause future results to differ materially from those contemplated. These factors include those listed at

Item 1A Risk Factors, in this report.

Forward-looking statements speak only as of the date they are made, and the Company does not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made, whether as a result of new information, future developments or otherwise.

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PART I

ITEM 1. BUSINESS

Information About TriCo Bancshares Business

TriCo Bancshares is a bank holding company incorporated in California in 1981 and registered under the Bank Holding Company Act of 1956, as amended (the BHC Act). The Company s principal subsidiary is Tri Counties Bank, a California-chartered commercial bank (the Bank). The Bank offers banking services to retail customers and small to medium-sized businesses through 63 branch offices in Northern and Central California. See Business of Tri Counties Bank . As a bank holding company, TriCo is subject to the supervision of the Board of Governors of the Federal Reserve System (the FRB) under the BHC Act. The Bank is subject to the supervision of the California Department of Business Oversight (the DBO) and the Federal Deposit Insurance Corporation (the FDIC). The Company and the Bank are headquartered in Chico, California.

On July 31, 2003, the Company formed a subsidiary business trust, TriCo Capital Trust I, to issue trust preferred securities. On June 22, 2004, the Company formed a subsidiary business trust, TriCo Capital Trust II, to issue additional trust preferred securities. See Note 17 in the financial statements at Item 8 of this report for a discussion about the Company s issuance of trust preferred securities. The Bank, TriCo Capital Trust I and TriCo Capital Trust II are TriCo s only subsidiaries and TriCo does not conduct any material business operations independent of the Bank, TriCo Capital Trust I and TriCo Capital Trust II.

Additional information concerning the Company can be found on our website at www.tcbk.com. Copies of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports are available free of charge through the investors relations page of our website, www.tcbk.com, as soon as reasonably practicable after the Company files these reports with the U.S. Securities and Exchange Commission (SEC). The information on our website is not incorporated into this annual report.

Business of Tri Counties Bank

The Bank was incorporated as a California banking corporation on June 26, 1974, and received its certificate of authority to begin banking operations on March 11, 1975. The Bank engages in the general commercial banking business in the California counties of Butte, Contra Costa, Del Norte, Fresno, Glenn, Kern, Lake, Lassen, Madera, Mendocino, Merced, Napa, Nevada, Placer, Sacramento, Shasta, Siskiyou, Stanislaus, Sutter, Tehama, Tulare, Yolo and Yuba. The Bank currently operates from 41 traditional branches and 22 in-store branches.

The Bank conducts a commercial banking business including accepting demand, savings and time deposits and making commercial, real estate, and consumer loans. It also offers installment note collection, issues cashier s checks, sells travelers checks and provides safe deposit boxes and other customary banking services. Brokerage services are provided at the Bank s offices by the Bank s association with Raymond James Financial Services, Inc., an independent financial services provider and broker-dealer. The Bank does not offer trust services or international banking services.

The Bank has emphasized retail banking since it opened. Most of the Bank s customers are retail customers and small to medium-sized businesses. The Bank emphasizes serving the needs of local businesses, farmers and ranchers, retired individuals and wage earners. The majority of the Bank s loans are direct loans made to individuals and businesses in Northern and Central California where its branches are located. At December 31, 2013, the total of the Bank s consumer loans net of deferred fees outstanding was $383,163,000 (22.9%), the total of commercial loans outstanding was $131,878,000 (7.9%), and the total of real estate loans including construction loans of $49,103,000 was

$1,156,966,000 (69.2%). The Bank takes real estate, listed and unlisted securities, savings and time deposits, automobiles, machinery, equipment, inventory, accounts receivable and notes receivable secured by property as collateral for loans.

Most of the Bank s deposits are attracted from individuals and business-related sources. No single person or group of persons provides a material portion of the Bank s deposits, the loss of any one or more of which would have a materially adverse effect on the business of the Bank, nor is a material portion of the Bank s loans concentrated within a single industry or group of related industries.

Agreement to acquire North Valley Bancorp

On January 21, 2014, TriCo announced that it had entered into an Agreement and Plan of Merger and Reorganization under which it would acquire North Valley Bancorp (North Valley). North Valley shareholders will receive a fixed exchange ratio of 0.9433 shares of TriCo common stock for each share of North Valley common stock, which would provide North Valley shareholders with aggregate ownership, on a pro forma basis, of approximately 28.6% of the common stock of the combined company. Based on TriCo s closing stock price of $27.66 on January 17, 2014, North Valley shareholders would have received consideration valued at approximately $26.09 per share.

The merger will not be completed unless a number of customary closing conditions are met, including, among others, approval of the merger by shareholders of both companies, the registration of the offering of the TriCo common stock to the North Valley shareholders under the Securities Act of 1933, receipt of required regulatory and other approvals and the

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expiration of applicable statutory waiting periods, the accuracy of specified representations and warranties of each party, the receipt of tax opinions confirming certain tax aspects of the merger, North Valley s satisfaction of certain financial measures shortly prior to closing, and the absence of any injunctions or other legal restraints.

TriCo has agreed to appoint three North Valley directors to TriCo s board upon closing of the merger. The merger is expected to be completed in the second or third quarter of 2014, subject to approval of the merger by shareholders of both companies, receipt of required regulatory and other approvals and satisfaction of customary closing conditions.

North Valley, headquartered in Redding, California, is the parent of North Valley Bank and had approximately $917.8 million in assets and 22 commercial banking offices in Shasta, Humboldt, Del Norte, Mendocino, Yolo, Sonoma, Placer and Trinity Counties in Northern California at December 31, 2013. In connection with the acquisition, North Valley Bank will merge into Tri Counties Bank.

As of December 31, 2013, on a pro forma consolidated basis with North Valley, TriCo would have had approximately $3.61 billion in assets.

Purchase and Assumption of Certain Assets and Liabilities of Citizens Bank of Northern California

On September 23, 2011, the Bank acquired certain of the assets and assumed substantially all of the liabilities of Citizens Bank of Northern California, Nevada City, California (Citizens), including substantially all the deposits from the FDIC, as receiver for Citizens. The acquisition was made pursuant to the terms of a purchase and assumption agreement entered into by the Bank and the FDIC. Based upon a preliminary closing with the FDIC as of September 23, 2011, the Bank acquired $167.5 million in loans, $9.4 million in investment securities, and $93.5 million in cash and other assets, and assumed an estimated $239.9 million in deposits, $22.0 million in borrowings, and $0.8 million in other liabilities. The Bank paid no cash or other consideration to acquire Citizens. See Note 2 in the financial statements at Item 8 of this report for a discussion about this transaction.

Purchase and Assumption of Certain Assets and Liabilities of Granite Community Bank

On May 28, 2010, the Bank acquired certain of the assets and assumed substantially all of the liabilities of Granite Community Bank, N.A., Granite Bay, California (Granite), including substantially all the deposits from the FDIC, as receiver for Granite. The acquisition was made pursuant to the terms of a purchase and assumption agreement entered into by the Bank and the FDIC. The Bank acquired $64.8 million in loans, $3.6 million in investment securities, and $31.9 million in cash and other assets, and assumed an estimated $95.0 million in deposits, $5.0 million in borrowings, and $0.05 million in other liabilities. The Bank paid no cash or other consideration to acquire Granite. In connection with the Acquisition, the Bank entered into a loss-sharing agreement with the FDIC that covered approximately $89.3 million of Granite s assets (before fair value adjustments). The Bank will share in the losses on the asset pools (loans, foreclosed loan collateral, and certain investment securities) covered under the loss-sharing agreement. Pursuant to the terms of the loss sharing agreement, the FDIC is obligated to reimburse the Bank for 80% of losses with respect to covered assets. The Bank will reimburse the FDIC for 80% of recoveries with respect to losses for which the FDIC paid the Bank under the loss sharing agreement.

Other Activities

The Bank may in the future engage in other businesses either directly or indirectly through subsidiaries acquired or formed by the Bank subject to regulatory constraints. See Regulation and Supervision .

Employees

At December 31, 2013, the Company and the Bank employed 794 persons, including seven executive officers. Full time equivalent employees were 733. No employees of the Company or the Bank are presently represented by a union or covered under a collective bargaining agreement. Management believes that its employee relations are good.

Competition

The banking business in California generally, and in the Bank s primary service area of Northern and Central California specifically, is highly competitive with respect to both loans and deposits. It is dominated by a relatively small number of national and regional banks with many offices operating over a wide geographic area. Among the advantages such major banks have over the Bank is their ability to finance wide ranging advertising campaigns and to allocate their investment assets to regions of high yield and demand. By virtue of their greater total capitalization such institutions have substantially higher lending limits than does the Bank.

In addition to competing with savings institutions, commercial banks compete with other financial markets for funds as a result of the deregulation of the financial services industry. Yields on corporate and government debt securities and other commercial paper may be higher than on deposits, and therefore affect the ability of commercial banks to attract and hold deposits. Commercial banks also compete for available funds with money market instruments and mutual funds. During past periods of high interest rates, money market funds have provided substantial competition to banks for deposits and they may continue to do so in the future. Mutual funds are also a major source of competition for savings dollars.

The Bank relies substantially on local promotional activity, personal contacts by its officers, directors, employees and shareholders, extended hours, personalized service and its reputation in the communities it services to compete effectively.

Regulation and Supervision

General

The Company and the Bank are subject to extensive regulation under both federal and state law. This regulation is intended primarily for the protection of depositors, the deposit insurance fund, and the banking system as a whole, and not for the protection of shareholders of the Company. Set forth below is a summary description of the significant laws and regulations applicable to the Company and the Bank. The description is qualified in its entirety by reference to the applicable laws and regulations.

Regulatory Agencies

The Company is a legal entity separate and distinct from the Bank and its other subsidiaries. As a bank holding company, the Company is regulated under the BHC Act, and is subject to supervision, regulation and inspection by the FRB. The Company is also under the jurisdiction of the SEC and is subject to the disclosure and regulatory requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934, each administered by the SEC. The Company s common stock is listed on the Nasdaq Global Select market (Nasdaq) under the trading symbol TCBK and the Company is, therefore, subject to the rules of Nasdaq for listed companies.

The Bank, as a state chartered bank, is subject to broad federal regulation and oversight extending to all its operations by the FDIC and to state regulation by the DBO.

Dodd-Frank Wall Street Reform and Consumer Protection Act

The implementation and impact of legislation and regulations enacted since 2008 in response to the U.S. economic downturn and financial industry instability continued in 2013 as modest recovery returned to many institutions in the banking sector. Certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which was enacted in 2010, are now effective and have been fully implemented, including revisions in the deposit insurance assessment base for FDIC insurance and the permanent increase in coverage to $250,000; the permissibility of paying interest on business checking accounts; the removal of barriers to interstate branching and required disclosure and shareholder advisory votes on executive compensation. Action in 2013 to implement the final Dodd-Frank provisions included (i) final new capital rules, (ii) a final rule to implement the so called Volcker rule restrictions on certain proprietary trading and investment activities and (iii) final rules and increased enforcement action by the Consumer Finance Protection Bureau (CFPB).

The Bank Holding Company Act

The Company is registered as a bank holding company under the BHC Act. In general, the BHC Act limits the business of bank holding companies to banking, managing or controlling banks and other activities that the FRB has determined to be so closely related to banking as to be a proper incident thereto. As a result of the Gramm-Bliley Act, which amended the BHC Act, qualified bank holding companies that elected to be financial holding companies may engage in any activity, or acquire and retain the shares of a company engaged in any activity, that is either (i) financial in nature or incidental to such financial activity (as determined by the FRB in consultation with the Office of the Comptroller of the Currency (the OCC)) or (ii) complementary to a financial activity, and that does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally (as determined solely by the FRB). Activities that are financial in nature include securities underwriting and dealing, insurance underwriting and agency, and making merchant banking investments. The Company has not elected to become a financial holding company.

The BHC Act, the Bank Merger Act, and other federal and state statutes regulate acquisitions of commercial banks. The BHC Act requires the prior approval of the FRB for the direct or indirect acquisition of more than 5 percent of the voting shares of a commercial bank or its parent holding company. Under the Bank Merger Act, the prior approval of an acquiring bank s primary federal regulator is required before it may merge with another bank or purchase the assets or assume the deposits of another bank. In reviewing applications seeking approval of merger and acquisition transactions, the bank regulatory authorities will consider, among other things, the competitive effect and public benefits of the transactions, the capital position of the combined organization, the applicant s performance record under the Community Reinvestment Act, consumer compliance, fair housing laws and the effectiveness of the subject organizations in combating money laundering activities.

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CFPB Actions

Dodd-Frank created the CFPB as an independent entity with broad rulemaking, supervisory and enforcement authority over consumer financial products and services, including deposit products, residential mortgages, home-equity loans and credit cards. The CFPB s functions include investigating consumer complaints, conducting market research, rulemaking, supervising and examining bank consumer transactions, and enforcing rules related to consumer financial products and services. CFPB regulations and guidance apply to all financial institutions and banks with $10 billion or more in assets are subject to examination by the CFPB. Banks with less than $10 billion in assets, including the Bank, will continue to be examined for compliance by their primary federal banking agency. Significant recent CFPB developments that may affect the Bank s operations and compliance costs include:

- The issuance of final rules for residential mortgage lending, which became effective January 10, 2013, including definitions for qualified mortgages and detailed standards by which lenders must satisfy themselves of the borrower s ability to repay the loan and revised forms of disclosure under the Truth in Lending Act and the Real Estate Settlement Procedures Act

- The issuance of a policy report on arbitration clauses which could result in the restriction or prohibition of lenders including arbitration clauses in consumer financial services contracts

- Actions taken to regulate and supervise credit bureaus and debt collections
- Positions taken by CFPB on fair lending, including applying the disparate impact theory in auto financing, which could make it harder for lenders to charge different rates or apply different terms to loans to different customers.

The Bank is not subject to examination by the CFPB but is required to comply with CFPB rules and regulations.

Safety and Soundness Standards

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) implemented certain specific restrictions on transactions and required the regulators to adopt overall safety and soundness standards for depository institutions related to internal control, loan underwriting and documentation, and asset growth. Among other things, FDICIA limits the interest rates paid on deposits by undercapitalized institutions, the use of brokered deposits and the aggregate extension of credit by a depository institution to an executive officer, director, principal stockholder or related interest, and reduces deposit insurance coverage for deposits offered by undercapitalized institutions for deposits by certain employee benefits accounts.

Section 39 to the Federal Deposit Insurance Act requires the agencies to establish safety and soundness standards for insured financial institutions covering:

- internal controls, information systems and internal audit systems;

- loan documentation;

- credit underwriting;
- interest rate exposure;
- asset growth;
- compensation, fees and benefits;
- asset quality, earnings and stock valuation; and
- excessive compensation for executive officers, directors or principal shareholders which could lead to material financial loss.

If an agency determines that an institution fails to meet any standard established by the guidelines, the agency may require the financial institution to submit to the agency an acceptable plan to achieve compliance with the standard. If the agency requires submission of a compliance plan and the institution fails to timely submit an acceptable plan or to implement an accepted plan, the agency must require the institution to correct the deficiency. An institution must file a compliance plan within 30 days of a request to do so from the institution s primary federal regulatory agency. The agencies may elect to initiate enforcement action in certain cases rather than rely on an existing plan particularly where failure to meet one or more of the standards could threaten the safe and sound operation of the institution.

Restrictions on Dividends and Distributions

A California corporation such as TriCo may make a distribution to its shareholders to the extent that either the corporation s retained earnings meet or exceed the amount of the proposed distribution or the value of the corporation s assets exceed the amount of its liabilities plus the amount of shareholders preferences, if any, and certain other conditions are met. It is the FRB s policy that bank holding companies should generally pay dividends on common stock only out of income available over the past year, and only if prospective earnings retention is consistent with the organization s expected future needs and financial condition.

The primary source of funds for payment of dividends by TriCo to its shareholders has been and will be the receipt of dividends and management fees from the Bank. TriCo s ability to receive dividends from the Bank is limited by applicable state and federal law. Under the California Financial Code, funds available for cash dividend payments by a bank are restricted to the lesser of: (i) retained earnings; or (ii) the bank s net income for its last three fiscal years (less any distributions to shareholders made during such period). However, with the prior approval of the Commissioner of the DBO, a bank may pay cash dividends in an amount not to exceed the greatest of the: (1) retained earnings of the bank; (2) net income of the bank for its last fiscal year; or (3) net income of the bank for its current fiscal year. However, if the DBO finds that the shareholders equity of the bank is not adequate or that the payment of a dividend would be unsafe or unsound, the Commissioner may order the bank not to pay a dividend to shareholders.

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Additionally, under FDICIA, a bank may not make any capital distribution, including the payment of dividends, if after making such distribution the bank would be in any of the undercapitalized categories under the FDIC s Prompt Corrective Action regulations. A bank is undercapitalized for this purpose if its leverage ratios, Tier 1 risk-based capital level and total risk-based capital ratio are not at least four percent, four percent and eight percent, respectively.

The FRB, FDIC and the DBO have authority to prohibit a bank holding company or a bank from engaging in practices which are considered to be unsafe and unsound. Depending on the financial condition of TriCo and the Bank and other factors, the FRB, FDIC or the DBO could determine that payment of dividends or other payments by TriCo or the Bank might constitute an unsafe or unsound practice.

Consumer Protection Laws and Regulations

The Company is subject to many federal consumer protection statues and regulations, some of which are discussed below.

The Community Reinvestment Act of 1977 is intended to encourage insured depository institutions, while operating safely and soundly, to help meet the credit needs of their communities. This act specifically directs the federal regulatory agencies to assess a bank s record of helping meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound practices. This act further requires the agencies to take a financial institution s record of meeting its community credit needs into account when evaluating applications for, among other things, domestic branches, mergers or acquisitions, or holding company formations. The agencies use the Community Reinvestment Act assessment factors in order to provide a rating to the financial institution. The ratings range from a high of outstanding to a low of substantial noncompliance.

The Equal Credit Opportunity Act generally prohibits discrimination in any credit transaction, whether for consumer or business purposes, on the basis of race, color, religion, national origin, sex, marital status, age (except in limited circumstances), receipt of income from public assistance programs, or good faith exercise of any rights under the Consumer Credit Protection Act. The Truth-in-Lending Act is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably.

The Fair Housing Act regulates many practices, including making it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status. The Home Mortgage Disclosure Act grew out of public concern over credit shortages in certain urban neighborhoods and provides public information that will help show whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. This act also includes a fair lending aspect that requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes.

The Real Estate Settlement Procedures Act requires lenders to provide borrowers with disclosures regarding the nature and cost of real estate settlements. Also, this act prohibits certain abusive practices, such as kickbacks, and places limitations on the amount of escrow accounts.

Penalties under the above laws may include fines, reimbursements, injunctive relief and other penalties.

USA Patriot Act of 2001

The USA Patriot Act was enacted in 2001 to combat money laundering and terrorist financing. The impact of the Patriot Act on financial institutions is significant and wide ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws and requires various regulations, including:

- due diligence requirements for financial institutions that administer, maintain, or manage private bank accounts or correspondent accounts for non-U.S. persons,
- standards for verifying customer identification at account opening,
- rules to promote cooperation among financial institutions, regulators, and law enforcement entities to assist in the identification of parties that may be involved in terrorism or money laundering,
- reports to be filed by non-financial trades and business with the Treasury Department s Financial Crimes Enforcement Network for transactions exceeding $10,000, and
- the filing of suspicious activities reports by securities brokers and dealers if they believe a customer may be violating U.S. laws and regulations.

Capital Requirements

Federal regulation imposes upon all financial institutions a variable system of risk-based capital guidelines designed to make capital requirements sensitive to differences in risk profiles among banking organizations, to take into account off-balance sheet exposures and to promote uniformity in the definition of bank capital uniform nationally.

The Bank and the Company are subject to the minimum capital requirements of the FDIC and the FRB, respectively. As a result of these requirements, the growth in assets is limited by the amount of its capital as defined by the respective regulatory agency. Capital requirements may have an effect on profitability and the payment of dividends on the common stock of the Bank and the Company. If an entity is unable to increase its assets without violating the minimum capital requirements or is forced to reduce assets, its ability to generate earnings would be reduced.

The FRB and the FDIC have adopted guidelines utilizing a risk-based capital structure. Qualifying capital is divided into two tiers. Tier 1 capital consists generally of common stockholders equity, qualifying noncumulative perpetual preferred stock, qualifying cumulative perpetual preferred stock (up to 25% of total Tier 1 capital) and minority interests in the equity accounts of consolidated subsidiaries, less goodwill and certain other intangible assets. Tier 2 capital consists of, among other things, allowance for loan and lease losses up to 1.25% of weighted risk assets, other perpetual preferred stock, hybrid capital instruments, perpetual debt, mandatory convertible debt securities, subordinated debt and intermediate-term preferred stock. Tier 2 capital qualifies as part of total capital up to a maximum of 100% of Tier 1 capital. Amounts in excess of these limits may be issued but are not included in the calculation of risk-based capital ratios. Under these risk-based capital guidelines, the Bank and the Company are required to maintain capital equal to at least 8% of its assets, of which at least 4% must be in the form of Tier 1 capital.

The guidelines also require the Company and the Bank to maintain a minimum leverage ratio of 4% of Tier 1 capital to total assets (the leverage ratio). The leverage ratio is determined by dividing an institution s Tier 1 capital by its quarterly average total assets, less goodwill and certain other intangible assets. The leverage ratio constitutes a minimum requirement for the most well-run banking organizations. See Note 29 in the financial statements at Item 8 of this report for a discussion about the Company s risk-based capital and leverage ratios.

New Capital Rules and the Basel Accords

The current risk-based capital guidelines which apply to the Company and the Bank are based upon the 1988 capital accord (referred to as Basel I) of the International Basel Committee on Banking Supervision (the Basel Committee), a committee of central banks and bank supervisors and regulators from the major industrialized countries. The Basel Committee develops broad policy guidelines for use by each country s supervisors in determining the supervisory policies they apply. On July 2, 2013, the FRB approved final rules that substantially amend the regulatory risk-based capital rules applicable to TriCo and the Bank. The FDIC has subsequently approved these rules. The final rules implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. Basel III refers to two consultative documents released by the Basel Committee on Banking Supervision in December 2009, the rules text released in December 2010, and loss absorbency rules issued in January 2011, which include significant changes to bank capital, leverage and liquidity requirements.

The rules include new risk-based capital and leverage ratios, which would be phased in from 2015 to 2019, and would refine the definition of what constitutes capital for purposes of calculating those ratios. The new minimum capital level requirements applicable to TriCo and the Bank under the final rules would be: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4% for all institutions. The final rules also establish a capital conservation buffer above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. The capital conservation buffer will be phased-in over four years beginning on January 1, 2016, as follows: the maximum buffer will be 0.625% of risk-weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. This will result in the following minimum ratios beginning in 2019: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. Under the final rules, institutions are subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions. Basel III provided discretion for regulators to impose an additional buffer, the countercyclical buffer, of up to 2.5% of common equity Tier 1 capital to take into account the macro-financial environment and periods of excessive credit growth. However, the final rules permit the countercyclical buffer to be applied only to advanced approach banks (i.e., banks with $250 billion or more in total assets or $10 billion or more in total foreign exposures), which currently excludes TriCo and the Bank. The final rules also implement revisions and clarifications consistent with Basel III regarding the various components of Tier 1 capital, including common equity, unrealized gains and losses, as well as certain instruments that will no longer qualify as Tier 1 capital, some of which will be phased out over time. However, the final rules provide that small depository institution holding companies with less than $15 billion in total assets as of December 31, 2009 (which includes TriCo) will be able to permanently include non-qualifying instruments that were issued and included in Tier 1 or Tier 2 capital prior to May 19, 2010 in additional Tier 1 or Tier 2 capital until they redeem such instruments or until the instruments mature.

The final rules also contain revisions to the prompt corrective action framework, which is designed to place restrictions on insured depository institutions, including the Bank, if their capital levels begin to show signs of weakness. These revisions take effect January 1, 2015. Under the prompt corrective action requirements, which are designed to complement the capital conservation buffer, insured depository institutions will be required to meet the following increased capital level requirements in order to qualify as well capitalized: (i) a new common equity Tier 1 capital ratio of 6.5%; (ii) a Tier 1 capital ratio of 8% (increased from 6%); (iii) a total capital ratio of 10% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 5% (increased from 4%).

The final rules set forth certain changes for the calculation of risk-weighted assets, which we will be required to utilize beginning January 1, 2015. The standardized approach final rule utilizes an increased number of credit risk exposure categories and risk weights, and also addresses: (i) an alternative standard of creditworthiness consistent with Section 939A of the Dodd-Frank Act Act; (ii) revisions to recognition of credit risk mitigation; (iii) rules for risk weighting of equity exposures and past due loans; (iv) revised capital treatment for derivatives and repo-style transactions; and (v) disclosure requirements for top-tier banking organizations with $50 billion or more in total assets that are not subject to the advance approach rules that apply to banks with greater than $250 billion in consolidated assets. Based on our current capital composition and levels, we believe that we would be in compliance with the requirements applicable to us as set forth in the final rules if they were presently in effect.

Prompt Corrective Action

Prompt Corrective Action Regulations of the federal bank regulatory agencies establish five capital categories in descending order (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized), assignment to which depends upon the institution s total risk-based capital ratio, Tier 1 risk-based capital ratio, and leverage ratio. Institutions classified in one of the three undercapitalized categories are subject to certain mandatory and discretionary supervisory actions, which include increased monitoring and review, implementation of capital restoration plans, asset growth restrictions, limitations upon expansion and new business activities, requirements to augment capital, restrictions upon deposit gathering and interest rates, replacement of senior executive officers and directors, and requiring divestiture or sale of the institution. The Bank has been classified as well-capitalized since adoption of these regulations.

Premiums for Deposit Insurance

Deposit accounts in the Bank are insured by the FDIC, generally up to a maximum of $250,000 per separately insured depositor. The Bank s deposits are subject to FDIC deposit insurance assessments. The Bank pays insurance assessments based on its consolidated total assets less tangible equity capital. This assessment is based on the risk category of the institution. To determine the total base assessment rate, the FDIC first establishes an institution s initial base assessment rate and then adjusts the initial base assessment based upon an institution s levels of unsecured debt, secured liabilities, and brokered deposits. The total base assessment rate ranges from 2.5 to 45 basis points of the institution s average consolidated total assets less tangible equity capital.

The Bank is generally unable to control the amount of premiums that it is required to pay for FDIC insurance. If there are additional bank or financial institution failures or if the FDIC otherwise determines, the Bank may be required to pay even higher FDIC premiums than the recently increased levels. These announced increases and any future increases in FDIC insurance premiums may have a material and adverse affect on the Company s earnings and could have a material adverse effect on the value of, or market for, the Company s common stock.

The FDIC may terminate a depository institution s deposit insurance upon a finding that the institution s financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices that pose a risk to the DIF or that may prejudice the interest of the bank s depositors. The termination of deposit insurance for the Bank would also result in the revocation of the Bank s charter by the DBO.

Impact of Monetary Policies

Banking is a business that depends on interest rate differentials. In general, the difference between the interest paid by a bank on its deposits and other borrowings, and the interest rate earned by banks on loans, securities and other interest-earning assets comprises the major source of banks earnings. Thus, the earnings and growth of banks are subject to the influence of economic conditions generally, both domestic and foreign, and also to the monetary and fiscal policies of the United States and its agencies, particularly the FRB. The FRB implements national monetary policy, such as seeking to curb inflation and combat recession, by its open-market dealings in United States government securities, by adjusting the required level of reserves for financial institutions subject to reserve requirements and through adjustments to the discount rate applicable to borrowings by banks which are members of the FRB. The actions of the FRB in these areas influence the growth of bank loans, investments and deposits and also affect interest rates. The nature and timing of any future changes in such policies and their impact on the Company cannot be predicted. In addition, adverse economic conditions could make a higher provision for loan losses a prudent course and could cause higher loan loss charge-offs, thus adversely affecting the Company s net earnings.

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ITEM 1A. RISK FACTORS

In analyzing whether to make or continue an investment in the Company, investors should consider, among other factors, the following:

Risks Related to the Nature and Geographic Area of Our Business

We are exposed to risks in connection with the loans we make.

A significant source of risk for us arises from the possibility that we will sustain losses because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans. Our earnings are significantly affected by our ability to properly originate, underwrite and service loans. We have underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for loan losses, that we believe to be appropriate to minimize this risk by assessing the likelihood of nonperformance, tracking loan performance and diversifying our respective loan portfolios. Such policies and procedures, however, may not prevent unexpected losses that could adversely affect our results of operations. We could sustain losses if we incorrectly assess the creditworthiness of our borrowers or fail to detect or respond to deterioration in asset quality in a timely manner.

Our allowance for loan losses may not be adequate to cover actual losses.

Like other financial institutions, we maintain an allowance for loan losses to provide for loan defaults and non-performance. Our allowance for loan losses may not be adequate to cover actual loan losses, and future provisions for loan losses could materially and adversely affect our business, financial condition, results of operations and cash flows. The allowance for loan losses reflects our estimate of the probable losses in our loan portfolio at the relevant balance sheet date. Our allowance for loan losses is based on prior experience, as well as an evaluation of the known risks in the current portfolio, composition and growth of the loan portfolio and economic factors. The determination of an appropriate level of loan loss allowance is an inherently difficult process and is based on numerous assumptions. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, that may be beyond our control and these losses may exceed current estimates. Federal and state regulatory agencies, as an integral part of their examination process, review our loans and allowance for loan losses. While we believe that our allowance for loan losses is adequate to cover current losses, we cannot assure you that we will not increase the allowance for loan losses further or that the allowance will be adequate to absorb loan losses we actually incur. Either of these occurrences could have a material adverse affect on our business, financial condition and results of operations.

Our business may be adversely affected by business conditions in Northern and Central California.

We conduct most of our business in Northern and Central California. As a result of this geographic concentration, our results are impacted by the difficult economic conditions in California. A deterioration in the economic conditions or a prolonged delay in economic recovery in California could result in the following consequences, any of which could have a material adverse effect on our business, financial condition, results of operations and cash flows:

- problem assets and foreclosures may increase,

- demand for our products and services may decline,
- low cost or non-interest bearing deposits may decrease, and
- collateral for loans made by us, especially real estate, may decline in value, in turn reducing customers borrowing power, and reducing the value of assets and collateral associated with our existing loans.

In view of the concentration of our operations and the collateral securing our loan portfolio in both Northern and Central California, we may be particularly susceptible to the adverse effects of any of these consequences, any of which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

A significant majority of the loans in our portfolio are secured by real estate and a downturn in our real estate markets could hurt our business.

A downturn in our real estate markets or prolonged delay in economic recovery in California could hurt our business because most of our loans are secured by real estate. Real estate values and real estate markets are generally affected by changes in national, regional or local economic conditions, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies and acts of nature. As real estate prices decline, the value of real estate collateral securing our loans is reduced. As a result, our ability to recover on defaulted loans by foreclosing and selling the real estate collateral could then be diminished and we would be more likely to suffer losses on defaulted loans. As of December 31, 2013, approximately 90.4% of the book value of our loan portfolio consisted of loans collateralized by various types of real estate. Substantially all of our real estate collateral is located in California. So if there is a significant adversely decline in real estate values in California, the collateral for our loans will provide less security. Real estate values could also be affected by, among other things, earthquakes, drought and national disasters in our markets. Any such downturn could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We depend on key personnel and the loss of one or more of those key personnel may materially and adversely affect our prospects.

Competition for qualified employees and personnel in the banking industry is intense and there are a limited number of qualified persons with knowledge of, and experience in, the California community banking industry. The process of recruiting personnel with the combination of skills and attributes required to carry out our strategies is often lengthy. Our success depends to a significant degree upon our ability to attract and retain qualified management, loan origination, finance, administrative, marketing and technical personnel and upon the continued contributions of our management and personnel. In particular, our success has been and continues to be highly dependent upon the abilities of our senior management team of Messrs. Smith, O Sullivan, Bailey, Reddish, Carney, Rios, Hunter and Ms. Ward, who have expertise in banking and experience in the California markets we serve and have targeted for future expansion. We also depend upon a number of other key executives who are California natives or are long-time residents and who are integral to implementing our business plan. The loss of the services of any one of our senior executive management team or other key executives could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We are exposed to risk of environmental liabilities with respect to properties to which we take title.

In the course of our business, we may foreclose and take title to real estate and could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean-up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, if we are the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we become subject to significant environmental liabilities, our business, financial condition, results of operations and cash flows could be materially adversely affected.

Strong competition in California could hurt our profits.

Competition in the banking and financial services industry is intense. Our profitability depends upon our continued ability to successfully compete. We compete exclusively in Northern and Central California for loans, deposits and customers with commercial banks, savings and loan associations, credit unions, finance companies, mutual funds, insurance companies, and brokerage and investment banking firms. In particular, our competitors include several major financial companies whose greater resources may afford them a marketplace advantage by enabling them to maintain numerous locations and mount extensive promotional and advertising campaigns. Additionally, banks and other financial institutions with larger capitalization and financial intermediaries not subject to bank regulatory restrictions may have larger lending limits which would allow them to serve the credit needs of larger customers. Areas of competition include interest rates for loans and deposits, efforts to obtain loan and deposit customers and a range in quality of products and services provided, including new technology-driven products and services. Technological innovation continues to contribute to greater competition in domestic and international financial services markets as technological advances enable more companies to provide financial services. We also face competition from out-of-state financial intermediaries that have opened loan production offices or that solicit deposits in our market areas. If we are unable to attract and retain banking customers, we may be unable to continue our loan growth and level of deposits and our business, financial condition, results of operations and cash flows may be adversely affected.

Our previous results may not be indicative of our future results.

We may not be able to sustain our historical rate of growth and level of profitability or may not even be able to grow our business or continue to be profitable at all. Various factors, such as economic conditions, regulatory and legislative considerations and competition, may also impede or prohibit our ability to expand our market presence and financial performance. If we experience a significant decrease in our historical rate of growth, our results of operations and financial condition may be adversely affected due to a high percentage of our operating costs being fixed expenses.

We may be adversely affected by the soundness of other financial institutions.

Financial services institutions are interrelated as a result of clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, and other institutional clients. Many of these transactions expose us to credit risk in the event of a default by a counterparty or client. In addition, our credit risk may be exacerbated when the collateral that we hold cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to us. Any such losses could have a material adverse affect on our financial condition and results of operations.

Recent health care legislation could increase our expenses or require us to pass further costs on to our employees, which could adversely affect our operations, financial condition and earnings.

Legislation enacted in 2010 requires companies to provide expanded health care coverage to their employees, such as affordable coverage to part-time employees and coverage to dependent adult children of employees. Companies will also be required to enroll new employees automatically into their health plans. Compliance with these and other new requirements of the health care legislation will increase our employee benefits expense, and may require us to pass these costs on to our employees, which could give us a competitive disadvantage in hiring and retaining qualified employees.

Our business may be adversely affected the continuing drought in California.

California is experiencing the third year of a severe drought. A considerable portion of our borrowers are involved in, or are impacted to some extent by, the agricultural industry, which is dependent on water. Agriculture operating loans comprised $33.5 million and $41.7 million, or 2.0% and 2.7%, of our loan portfolio at December 31, 2013 and 2012, respectively. We also originate agriculture real estate loans, which comprised $55.5 million and $65.2 million or 3.3% and 4.2% of our loan portfolio at December 31, 2013 and 2012. As a result of the drought, there are various governmental proposals concerning the distribution or rationing of water. If the amount of water available to agriculture in our market areas becomes increasingly scarce due to drought, rationing and/or diversion, growers may not be able to continue to produce agricultural products at a reasonable profit, which has the potential to force many out of business. While many of our borrowers are not directly involved in agriculture, they could be impacted by difficulties in the agricultural industry because many jobs in our market areas are ancillary to the production, processing, marketing and sales of agricultural products. The drought has the potential to adversely affect agricultural industries as well as consumer purchasing power, and could lead to further unemployment throughout our market area. The drought therefore could have a material adverse effect on our business, financial condition, results of operations and asset quality.

Market and Interest Rate Risk

Decreasing interest rates could hurt our profits.

Our ability to earn a profit, like that of most financial institutions, depends on our net interest income, which is the difference between the interest income we earn on our interest-earning assets, such as mortgage loans and investments, and the interest expense we pay on our interest-bearing liabilities, such as deposits. Our profitability depends on our ability to manage our assets and liabilities during periods of changing market interest rates. Recently, the FRB has maintained the targeted federal funds rate at record low levels. A sustained decrease in market interest rates could adversely affect our earnings. When interest rates decline, borrowers tend to refinance higher-rate, fixed-rate loans at lower rates. Under those circumstances, we would not be able to reinvest those prepayments in assets earning interest rates as high as the rates on the prepaid loans on investment securities. In addition, our commercial real estate and commercial loans, which carry interest rates that adjust in accordance with changes in the prime rate, will adjust to lower rates.

Our business is subject to interest rate risk and variations in interest rates may negatively affect our financial performance.

Because of the differences in the maturities and repricing characteristics of our interest-earning assets and interest-bearing liabilities, changes in interest rates do not produce equivalent changes in interest income earned on interest-earning assets and interest paid on interest-bearing liabilities. Accordingly, fluctuations in interest rates could adversely affect our interest rate spread and, in turn, our profitability. In addition, loan origination volumes are affected by market interest rates. Rising interest rates, generally, are associated with a lower volume of loan originations while lower interest rates are usually associated with higher loan originations. Conversely, in rising interest rate environments, loan repayment rates may decline and in falling interest rate environments, loan repayment rates may increase. Although we have been successful in generating new loans during 2013, the continuation of historically low long-term interest rate levels may cause additional refinancing of commercial real estate and 1-4 family residence loans, which may depress our loan volumes or cause rates on loans to decline. In addition, an increase in the general level of short-term interest rates on variable rate loans may adversely affect the ability of certain borrowers to pay the interest on and principal of their obligations or reduce the amount they wish to borrow. Additionally, if short-term market rates rise, in order to retain existing deposit customers and attract new deposit customers we may need to increase rates we pay on deposit accounts. Accordingly, changes in levels of market interest rates could materially and adversely affect our net interest spread, asset quality, loan origination volume, business, financial condition, results of operations and cash flows.

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Regulatory Risks

Recently enacted financial reform legislation will, among other things, create a new Consumer Financial Protection Bureau, tighten capital standards and result in new laws and regulations that are expected to increase our costs of operations.

On July 21, 2010, the President signed the Dodd-Frank Act. This new law significantly changes the current bank regulatory structure and affects the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting the implementing rules and regulations, and consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for many months or years.

Among other things, the Dodd-Frank Act creates a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The CFPB has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit unfair, deceptive or abusive acts and practices. The CFPB has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. Banks such as the Bank with $10 billion or less in assets will continue to be examined for compliance with the consumer laws by their primary bank regulators. The Dodd-Frank Act also weakens the federal preemption rules that have been applicable for national banks and federal savings associations, and gives state attorneys general the ability to enforce federal consumer protection laws.

The Dodd-Frank Act requires minimum leverage (Tier 1) and risk based capital requirements for bank and savings and loan holding companies that are no less than those applicable to banks, which will exclude certain instruments that previously have been eligible for inclusion by bank holding companies as Tier 1 capital, such as trust preferred securities (unless such securities were issued prior to May 19, 2010 by a bank holding company with less than $15 billion in assets).

It is difficult to predict at this time what specific impact the Dodd-Frank Act and the yet to be written implementing rules and regulations will have on community banks. However, it is expected that at a minimum they will increase our operating and compliance costs and could increase our interest expense.

We operate in a highly regulated environment and we may be adversely affected by changes in laws and regulations. Regulations may prevent or impair our ability to pay dividends, engage in acquisitions or operate in other ways.

We are subject to extensive regulation, supervision and examination by the DBO, FDIC, and the FRB. See Item 1 Regulation and Supervision of this report for information on the regulation and supervision which governs our activities. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on our operations, the classification of our assets and determination of the level of our allowance for loan losses. Banking regulations, designed primarily for the protection of depositors, may limit our growth and the return to our shareholders by restricting certain of our activities, such as:

- the payment of dividends to our shareholders,
- possible mergers with or acquisitions of or by other institutions,

- desired investments,
- loans and interest rates on loans,
- interest rates paid on deposits,
- the possible expansion of branch offices, and
- the ability to provide securities or trust services.

We also are subject to capitalization guidelines set forth in federal legislation and could be subject to enforcement actions to the extent that we are found by regulatory examiners to be undercapitalized. We cannot predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that such changes may have on our future business and earnings prospects. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on our operations.

Compliance with changing regulation of corporate governance and public disclosure may result in additional risks and expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Dodd-Frank Act, the Sarbanes-Oxley Act of 2002 and new SEC regulations, are creating additional expense for publicly-traded companies such as TriCo. The application of these laws, regulations and standard may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, our efforts to comply with evolving laws, regulations and standards have resulted in, and are likely to continue to result in, increased expenses and a diversion of management time and attention. In particular, our efforts to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations regarding management s required assessment of its internal control over financial reporting and its external auditors audit of that assessment has required the commitment of significant financial and managerial resources. We expect these efforts to require the continued commitment of significant resources. Further, the members of our board of directors, members of our audit or compensation and management succession committees, our chief executive officer, our chief financial officer and certain other executive officers could face an increased risk of personal liability in connection with the performance of their duties. It may also become more difficult and more expensive to obtain director and officer liability insurance. As a result, our ability to attract and retain executive officers and qualified board and committee members could be more difficult.

We could be adversely affected by new regulations.

Federal and state governments and regulators could pass legislation and adopt policies responsive to current credit conditions that would have an adverse affect on the Company and its financial performance. For example, the Company could experience higher credit losses because of federal or state legislation or regulatory action that limits the Bank s ability to foreclose on property or other collateral or makes foreclosure less economically feasible.

Risks Related to Growth and Expansion

If we cannot attract deposits, our growth may be inhibited.

We plan to increase the level of our assets, including our loan portfolio. Our ability to increase our assets depends in large part on our ability to attract additional deposits at favorable rates. We intend to seek additional deposits by offering deposit products that are competitive with those offered by other financial institutions in our markets and by establishing personal relationships with our customers. We cannot assure that these efforts will be successful. Our inability to attract additional deposits at competitive rates could have a material adverse effect on our business, financial condition, results of operations and cash flows.

There are potential risks associated with future acquisitions and expansions.

We intend to continue to explore expanding our branch system through opening new bank branches and in-store branches in existing or new markets in Northern and Central California. In the ordinary course of business, we evaluate potential branch locations that would bolster our ability to cater to the small business, individual and residential lending markets in California. Any given new branch, if and when opened, will have expenses in excess of revenues for varying periods after opening that may adversely affect our results of operations or overall financial condition.

In addition, to the extent that we acquire other banks in the future, our business may be negatively impacted by certain risks inherent with such acquisitions. These risks include:

- incurring substantial expenses in pursuing potential acquisitions without completing such acquisitions,
- losing key clients as a result of the change of ownership,

- the acquired business not performing in accordance with our expectations,
- difficulties arising in connection with the integration of the operations of the acquired business with our operations,
- needing to make significant investments and infrastructure, controls, staff, emergency backup facilities or other critical business functions that become strained by our growth,
- management needing to divert attention from other aspects of our business,
- potentially losing key employees of the acquired business,
- incurring unanticipated costs which could reduce our earnings per share,
- assuming potential liabilities of the acquired company as a result of the acquisition, and
- an acquisition may dilute our earnings per share, in both the short and long term, or it may reduce our tangible capital ratios.

As result of these risks, any given acquisition, if and when consummated, may adversely affect our results of operations or financial condition. In addition, because the consideration for an acquisition may involve cash, debt or the issuance of shares of our stock and may involve the payment of a premium over book and market values, existing shareholders may experience dilution in connection with any acquisition.

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Our growth and expansion may strain our ability to manage our operations and our financial resources.

Our financial performance and profitability depend on our ability to execute our corporate growth strategy. In addition to seeking deposit and loan and lease growth in our existing markets, we may pursue expansion opportunities in new markets. Continued growth, however, may present operating and other problems that could adversely affect our business, financial condition, results of operations and cash flows. Accordingly, there can be no assurance that we will be able to execute our growth strategy or maintain the level of profitability that we have recently experienced.

Our growth may place a strain on our administrative, operational and financial resources and increase demands on our systems and controls. This business growth may require continued enhancements to and expansion of our operating and financial systems and controls and may strain or significantly challenge them. In addition, our existing operating and financial control systems and infrastructure may not be adequate to maintain and effectively monitor future growth. Our continued growth may also increase our need for qualified personnel. We cannot assure you that we will be successful in attracting, integrating and retaining such personnel.

Our decisions regarding the fair value of assets acquired from Citizens and Granite, including the FDIC loss sharing assets associated with Granite, could be inaccurate which could materially and adversely affect our business, financial condition, results of operations, and future prospects.

Management makes various assumptions and judgments about the collectability of acquired loans, including the creditworthiness of borrowers and the value of the real estate and other assets serving as collateral for the repayment of secured loans. In FDIC-assisted acquisitions that include loss sharing agreements, such as our acquisition of Granite, we may record a loss sharing asset that we consider adequate to absorb future losses which may occur in the acquired loan portfolio. In determining the size of the loss sharing asset, we analyze the loan portfolio based on historical loss experience, volume and classification of loans, volume and trends in delinquencies and nonaccruals, local economic conditions, and other pertinent information.

If our assumptions are incorrect, the balance of the FDIC indemnification asset may at any time be insufficient to cover future loan losses, and credit loss provisions may be needed to respond to different economic conditions or adverse developments in the acquired loan portfolio. Any increase in future loan losses could have a negative effect on our operating results.

Our ability to obtain reimbursement under the loss sharing agreement on covered assets purchased from the FDIC depends on our compliance with the terms of the loss sharing agreement.

We must certify to the FDIC on a quarterly basis our compliance with the terms of the FDIC loss sharing agreement as a prerequisite to obtaining reimbursement from the FDIC for realized losses on covered assets. The required terms of the agreements are extensive and failure to comply with any of the guidelines could result in a specific asset or group of assets permanently losing their loss sharing coverage. Additionally, Management may decide to forgo loss share coverage on certain assets to allow greater flexibility over the management of certain assets. As of December 31, 2013, $28,586,000, or 1.0%, of the Company s assets were covered by these FDIC loss sharing agreements.

Risks Relating to Dividends and Our Common Stock

Our future ability to pay dividends is subject to restrictions.

Since we are a holding company with no significant assets other than the Bank, we currently depend upon dividends from the Bank for a substantial portion of our revenues. Our ability to continue to pay dividends in the future will continue to depend in large part upon our receipt of dividends or other capital distributions from the Bank. The ability of the Bank to pay dividends or make other capital distributions to us is subject to the restrictions in the California Financial Code and the DBO. As of December 31, 2013, the Bank could have paid $44,548,000 in dividends without the prior approval of the DBO. The amount that the Bank may pay in dividends is further restricted due to the fact that the Bank must maintain a certain minimum amount of capital to be considered a well capitalized institution as further described under Item 1 Capital Requirements in this report.

From time to time, we may become a party to financing agreements or other contractual arrangements that have the effect of limiting or prohibiting us or the Bank from declaring or paying dividends. Our holding company expenses and obligations with respect to our trust preferred securities and corresponding junior subordinated deferrable interest debentures issued by us may limit or impair our ability to declare or pay dividends. Finally, our ability to pay dividends is also subject to the restrictions of the California Corporations Code. See Regulation and Supervision Restrictions on Dividends and Distributions .

Only a limited trading market exists for our common stock, which could lead to price volatility.

Our common stock is quoted on Nasdaq and trading volumes have been modest. The limited trading market for our common stock may cause fluctuations in the market value of our common stock to be exaggerated, leading to price volatility in excess of that which would occur in a more active trading market of our common stock. In addition, even if a more active market in our common stock develops, we cannot assure you that such a market will continue or that shareholders will be able to sell their shares.

Anti-takeover provisions and federal law may limit the ability of another party to acquire us, which could cause our stock price to decline.

Various provisions of our articles of incorporation and bylaws could delay or prevent a third party from acquiring us, even if doing so might be beneficial to our shareholders. These provisions provide for, among other things:

- specified actions that the Board of Directors shall or may take when an offer to merge, an offer to acquire all assets or a tender offer is received,
- a shareholder rights plan which could deter a tender offer by requiring a potential acquiror to pay a substantial premium over the market price of our common stock,
- advance notice requirements for proposals that can be acted upon at shareholder meetings, and
- the authorization to issue preferred stock by action of the board of directors acting alone, thus without obtaining shareholder approval.

The BHC Act and the Change in Bank Control Act of 1978, as amended, together with federal regulations, require that, depending on the particular circumstances, either FRB approval must be obtained or notice must be furnished to the FRB and not disapproved prior to any person or entity acquiring control of a bank holding company such as TriCo. These provisions may prevent a merger or acquisition that would be attractive to shareholders and could limit the price investors would be willing to pay in the future for our common stock.

The amount of common stock owned by, and other compensation arrangements with, our officers and directors may make it more difficult to obtain shareholder approval of potential takeovers that they oppose.

As of December 31, 2013, directors and executive officers beneficially owned approximately 14.4% of our common stock and our Employee Stock Ownership Plan owned approximately 8.2%. Agreements with our senior management also provide for significant payments under certain circumstances following a change in control. These compensation arrangements, together with the common stock and option ownership of our board of directors and management, could make it difficult or expensive to obtain majority support for shareholder proposals or potential acquisition proposals of us that our directors and officers oppose.

We may issue additional common stock or other equity securities in the future which could dilute the ownership interest of existing shareholders.

In order to maintain our capital at desired or regulatorily-required levels, or to fund future growth, our board of directors may decide from time to time to issue additional shares of common stock, or securities convertible into, exchangeable for or representing rights to acquire shares of our common stock. The sale of these shares may significantly dilute your ownership interest as a shareholder. New investors in the future may also have rights, preferences and privileges senior to our current shareholders which may adversely impact our current shareholders.

Holders of our junior subordinated debentures have rights that are senior to those of our common stockholders.

We have supported our continued growth through the issuance of trust preferred securities from special purpose trusts and accompanying junior subordinated debentures. At December 31, 2013, we had outstanding trust preferred securities and accompanying junior subordinated debentures totaling $41,238,000. Payments of the principal and interest on the trust preferred securities are conditionally guaranteed by us. Further, the accompanying junior subordinated debentures we issued to the trusts are senior to our shares of common stock. As a result, we must make payments on the junior subordinated debentures before any dividends can be paid on our common stock and, in the event of our bankruptcy, dissolution or liquidation, the holders of the junior subordinated debentures must be satisfied before any distributions can be made on our common stock.

Risks Relating to Systems, Accounting and Internal Controls

If we fail to maintain an effective system of internal and disclosure controls, we may not be able to accurately report our financial results or prevent fraud. As a result, current and potential shareholders could lose confidence in our financial reporting, which would harm our business and the trading price of our securities.

Effective internal control over financial reporting and disclosure controls and procedures are necessary for us to provide reliable financial reports and effectively prevent fraud and to operate successfully as a public company. If we cannot provide

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reliable financial reports or prevent fraud, our reputation and operating results would be harmed. We continually review and analyze our internal control over financial reporting for Sarbanes-Oxley Section 404 compliance. As part of that process we may discover material weaknesses or significant deficiencies in our internal control as defined under standards adopted by the Public Company Accounting Oversight Board that require remediation. Material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company s annual or interim financial statements will not be prevented or detected in a timely basis. Significant deficiency is a deficiency or combination of deficiencies, in internal control over financial reporting that is less severe than material weakness, yet important enough to merit attention by those responsible for the oversight of the Company s financial reporting.

As a result of weaknesses that may be identified in our internal control, we may also identify certain deficiencies in some of our disclosure controls and procedures that we believe require remediation. If we discover weaknesses, we will make efforts to improve our internal and disclosure control. However, there is no assurance that we will be successful. Any failure to maintain effective controls or timely effect any necessary improvement of our internal and disclosure controls could harm operating results or cause us to fail to meet our reporting obligations, which could affect our ability to remain listed with Nasdaq. Ineffective internal and disclosure controls could also cause investors to lose confidence in our reported financial information, which would likely have a negative effect on the trading price of our securities.

We rely on communications, information, operating and financial control systems technology and we may suffer an interruption in or breach of the security of those systems.

We rely heavily on our communications, information, operating and financial control systems technology to conduct our business. We rely on third party services providers to provide many of these systems. Any failure, interruption or breach in security of these systems could result in failures or interruptions in our customer relationship management, general ledger, deposit, servicing and loan origination systems. We cannot assure you that such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed by us or the third parties service providers on which we rely. The occurrence of any failures, interruptions or security breaches could damage our reputation, result in a loss of customers, expose us to possible financial liability, lead to additional regulatory scrutiny or require that we make expenditures for remediation or prevention. Any of these circumstances could have a material adverse effect on our business, financial condition, results of operations and cash flows.

A failure to implement technological advances could negatively impact our business.

The banking industry is undergoing technological changes with frequent introductions of new technology-driven products and services. In addition to improving customer services, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, in part, on our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources than we do to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or successfully market such products and services to our customers.

Risks Related to the Announced Merger with North Valley Bancorp

Failure to consummate the Merger, or a delay in consummating the Merger, could negatively impact the market price of TriCo common stock and could have a material adverse effect on our business, financial condition and results of operations.

On January 21, 2014, TriCo and North Valley Bancorp entered into an Agreement and Plan of Merger and Reorganization (the Merger Agreement) providing for the merger of North Valley Bancorp with and into TriCo, with Trico as the surviving entity (the Merger).

Consummation of the Merger is subject to various customary conditions, including (i) approval by TriCo s shareholders and North Valley Bancorp s shareholders, (ii) receipt of certain required regulatory approvals without materially burdensome regulatory conditions, (iii) the absence of any governmental order or law prohibiting the consummation of the Merger, and (iv) effectiveness of the registration statement for the TriCo common stock to be issued as consideration in the Merger.

We have incurred substantial expenses in connection with the negotiation and preparations for completion of the transactions contemplated by the Merger Agreement. If the Merger is not completed, we will have incurred these expenses without realizing the expected benefits of the Merger. If the Merger is not consummated for any reason, our ongoing business, financial condition and results of operations may be materially adversely affected and the market price of TriCo common stock may decline significantly, particularly to the extent that the current market price reflects a market assumption that the Merger will be consummated. If the consummation of the Merger is delayed, including by a delay in receipt of necessary governmental approvals or by the receipt of a competing acquisition proposal or by reason of litigation, our business, financial condition and results of operations may also be materially adversely affected. Additionally, if the Merger Agreement is terminated, under certain circumstances, TriCo could be required to pay a termination fee to North Valley

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Bancorp equal to $3,800,000. In addition, our business may have been impacted adversely by the failure to pursue other beneficial opportunities due to the focus of management on the Merger, without realizing any of the anticipated benefits of completing the Merger.

We may fail to realize the cost savings we have estimated for the Merger or integrate the business operations and managements of our two companies in an efficient manner.

The success of the Merger will depend, in part, on our ability to realize anticipated cost savings and to combine the businesses of TriCo and North Valley Bancorp in a manner that permits growth opportunities to be realized and does not materially disrupt the existing customer relationships of the Tri Counties Bank or North Valley Bank, nor result in decreased revenues due to any loss of customers.

TriCo and North Valley Bancorp have operated and, until the completion of the Merger, will continue to operate independently. To realize these anticipated benefits, the businesses of TriCo and North Valley and Tri Counties Bank and North Valley Bank must be successfully combined. While management has taken existing leases and other contractual obligations into consideration in developing its estimate of cost savings, changes in transaction volumes, operating systems and procedures and other factors may cause the actual cost savings to be different from these estimates. In addition, difficulties encountered in integrating our information systems could prevent us from realizing some of the estimated cost savings. Such difficulties could also jeopardize customer relationships and cause a loss of deposits or loan customers and the revenue associated with those customers. It is possible that the integration process could result in the loss of key employees, as well as the disruption of each company s ongoing businesses or inconsistencies in standards, controls, procedures and policies, any or all of which could adversely affect our ability to maintain relationships with customers and employees after the Merger or to achieve the anticipated benefits of the Merger. Integration efforts between the two companies will also divert management attention and resources. A failure to successfully navigate the complicated integration process could have an adverse effect on the combined companies or the combined bank. If the combined bank is not able to achieve these cost-savings objectives, the anticipated benefits of the Merger may not be realized fully or at all or may take longer to realize than expected.

We are subject to various uncertainties and contractual restrictions while the Merger is pending that could disrupt the conduct of our business and could have a material adverse effect on our business, financial condition and results of operations.

Uncertainty about the effect of the Merger on employees, customers, suppliers, and vendors may have a material adverse effect on our business, financial condition and results of operations. These uncertainties may impair our ability or the ability of North Valley Bancorp to attract, retain and motivate key personnel, depositors and borrowers pending the consummation of the Merger, as such personnel, depositors and borrowers may experience uncertainty about their future roles following the consummation of the Merger. Additionally, these uncertainties could cause customers (including depositors and borrowers), suppliers, vendors and others who deal with us to seek to change existing business relationships with us or fail to extend an existing relationship with us. In addition, competitors may target our existing customers by highlighting potential uncertainties and integration difficulties that may result from the Merger.

In addition, the Merger Agreement restricts us from taking certain actions without North Valley Bancorp s consent while the Merger is pending. These restrictions may, among other matters, prevent us from pursuing certain transactions or making other changes to our business prior to consummation of the Merger or termination of the Merger Agreement. These restrictions could have a material adverse effect on our business, financial condition and results of operations.

We have a small number of key personnel. The pursuit of the Merger and the preparation for the integration may place a burden on management and internal resources. Any significant diversion of management attention away from ongoing business concerns and any difficulties encountered in the transition and integration process could have a material adverse effect on our business, financial condition and results of operations.

The consideration to be paid in the Merger is fixed and will not be adjusted for changes in the business, assets, liabilities, prospects, outlook, financial condition or results of operations of TriCo or North Valley Bancorp, or in the event of any change in our stock price or North Valley Bancorp s stock price.

The Merger Agreement provides that the merger consideration, i.e. the number of shares of TriCo common stock that we will issue to holders of North Valley Bancorp common stock, is fixed and will not be adjusted for changes in our business, assets, liabilities, prospects, outlook, financial condition or results of operations, or changes in the market price of, analyst estimates of, or projections relating to, TriCo common stock or those of North Valley Bancorp. For example, if we experienced an improvement in our business, assets, liabilities, prospects, outlook, financial condition or results of operations prior to the consummation of the Merger, there would be no adjustment to the amount of the merger consideration.

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The market price of our common stock after the Merger may be affected by factors different from those affecting our shares currently.

The results of operations of the combined company and the market price of our common stock after the completion of the Merger may be affected by factors different from those currently affecting the independent results of our operations and the market price of our common stock.

The costs relating to the Merger could reduce our future earnings per share.

We estimate that we have incurred or will incur significant transaction costs associated with the Merger, a portion of which will be incurred whether or not the Merger closes. We believe the combined company may incur charges to operations, which are not currently reasonably estimable, in the quarter in which the Merger is completed or subsequent quarters, to reflect costs associated with integrating Tri Counties Bank and North Valley Bank. There is no assurance that the combined company will not incur additional material charges in subsequent quarters to reflect additional costs associated with the Merger, including charges associated with the impairment of any goodwill booked in connection with the Merger.

The Failure of Tri Counties Bank s or North Valley Bank s Loan Portfolios to Perform as Expected May Unfavorably Impact Us.

Our performance and prospects after the Merger will be dependent to a significant extent on the performance of the combined loan portfolios of Tri Counties Bank and North Valley Bank, and ultimately on the financial condition of their respective borrowers and other customers. The existing loan portfolios of the two banks differ to some extent in the types of borrowers, industries and credits represented. In addition, there are differences in the documentation, classifications, underwriting and management of the portfolios. As a result, our overall loan portfolio after the Merger will have a different risk profile than the loan portfolio of either Tri Counties Bank or North Valley Bank before the Merger. The performance of the two loan portfolios will be adversely affected if any of such factors is worse than currently anticipated. In addition, to the extent that present customers are not retained by North Valley Bancorp or North Valley Bank, or additional expenses are incurred in retaining them, there could be adverse effects on our future consolidated results of operations following the Merger. The anticipated benefits of the Merger are dependent, in part, on the extent to which the revenues of North Valley Bancorp are maintained and enhanced.

Goodwill resulting from the Merger may adversely affect our results of operations.

Goodwill and other intangible assets are expected to increase substantially as a result of the Merger. Potential impairment of goodwill and amortization of other intangible assets could adversely affect our financial condition and results of operations. We assess our goodwill and other intangible assets and long-lived assets for impairment annually and more frequently when required by U.S. GAAP. We are required to record an impairment charge if circumstances indicate that the asset carrying values exceed their fair values. Our assessment of goodwill, other intangible assets, or long-lived assets could indicate that an impairment of the carrying value of such assets may have occurred that could result in a material, non-cash write-down of such assets, which could have a material adverse effect on our results of operations and future earnings.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company is engaged in the banking business through 63 offices in 23 counties in Northern and Central California including ten offices in Shasta County, nine in Butte County, seven in Sacramento and Nevada Counties, six in Placer County, four in Stanislaus County, three each in Siskiyou, Sutter and Kern Counties, two each in Glenn and Yolo Counties, and one each in Contra Costa, Del Norte, Fresno, Lake, Lassen, Madera, Mendocino, Merced, Napa, Tehama, Tulare, and Yuba Counties. All offices are constructed and equipped to meet prescribed security requirements.

The Company owns twenty branch office locations, four administrative buildings, and two other buildings that it leases out. The Company leases forty-three branch office locations, and one administrative building. Most of the leases contain multiple renewal options and provisions for rental increases, principally for changes in the cost of living index, property taxes and maintenance.

ITEM 3. LEGAL PROCEEDINGS

The Bank owns 10,214 shares of Class B common stock of Visa Inc. which are convertible into Class A common stock at a conversion ratio of 0.4206 per Class A share. As of December 31, 2013, the value of the Class A shares was $222.68 per share. Utilizing the conversion ratio, the value of unredeemed Class A equivalent shares owned by the Bank was $957,000 as of December 31, 2013, and has not been reflected in the accompanying financial statements. The shares of Visa Class B common stock are restricted and may not be transferred. Visa Member Banks are required to fund an escrow account to cover settlements, resolution of pending litigation and related claims. If the funds in the escrow account are insufficient to settle all the covered litigation, Visa may sell additional Class A shares, use the proceeds to settle litigation, and further reduce the conversion ratio. If funds remain in the escrow account after all litigation is settled, the Class B conversion ratio will be increased to reflect that surplus.

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On January 24, 2014, a putative shareholder class action lawsuit was filed against TriCo, North Valley Bancorp and certain other defendants in connection with TriCo entering into the Merger Agreement with North Valley Bancorp. The lawsuit, which was filed in the Shasta County, California Superior Court, alleges that the members of the North Valley Bancorp board of directors breached their fiduciary duties to North Valley Bancorp shareholders by approving the proposed merger for inadequate consideration; approving the transaction in order receive benefits not equally shared by other North Valley Bancorp shareholders; entering into the Merger Agreement containing preclusive deal protection devices; and failing to take steps to maximize the value to be paid to the North Valley Bancorp shareholders. The lawsuit alleges claims against TriCo for aiding and abetting these alleged breaches of fiduciary duties. The plaintiff seeks, among other things, declaratory and injunctive relief concerning the alleged breaches of fiduciary duties injunctive relief prohibiting consummation of the merger, rescission, attorneys of the merger agreement, fees and costs, and other and further relief. At this stage, TriCo is unable to predict the outcome of the proceedings or their impact on TriCo or North Valley Bancorp.

On September 27, 2012, the Company announced that the Bank entered into a tentative settlement with a former employee who filed a class action lawsuit against the Bank in the Superior Court of California, Kern County on behalf of herself and a putative class of current and former Bank employees serving as assistant branch managers seeking undisclosed damages, alleging that the Bank improperly classified its assistant branch managers as exempt employees under California laws. The lawsuit alleges claims for: failure to pay overtime compensation; failure to provide meal periods; failure to provide rest periods; failure to provide accurate wage statements; failure to provide suitable seating; declaratory relief; accounting; and unfair business practices in violation of California Business and Professions Code section 17200. On September 26, 2012, after efforts to mediate the claim, the Bank and the former employee agreed to settle the case in an amount ranging from $2,039,500 to $2,500,000, depending primarily on the number of class participants who file claims, and pending final approval by the court, including determination of the method to allocate settlement payments among current and former employees who are members of the defined settlement class, and the portion of the total settlement allocable to attorney s fees and costs to plaintiff s counsel. On September 26, 2012, the Bank recorded a $2,090,000 expense and accrued liability in anticipation of approval of this settlement by the court and estimated related payroll taxes. On May 7, 2013, the court preliminariy approved the settlement. On August 27, 2013, the court approved a final settlement agreement for $2,429,000, and the Bank recorded an additional $339,000 expense and accrued liability related to this matter. During September 2013, the Bank paid the settlement amount.

The Bank is named as defendant in a lawsuit filed by a former employee seeking undisclosed damages, alleging that the Bank improperly terminated his employment under California law. The Bank denies all allegations and is vigorously defending the suit.

Neither the Company nor its subsidiaries, are party to any other material pending legal proceeding, nor is their property the subject of any material pending legal proceeding, except routine legal proceedings arising in the ordinary course of their business. None of these proceedings is expected to have a material adverse impact upon the Company s business, consolidated financial position or results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Inapplicable.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Common Stock Market Prices and Dividends

The Company s common stock is traded on the Nasdaq under the symbol TCBK. The following table shows the high and the low closing sale prices for the common stock for each quarter in the past two years, as reported by Nasdaq:

	High	Low
2013:		
Fourth quarter	$ 28.76	$ 22.50
Third quarter	$ 23.07	$ 20.50
Second quarter	$ 21.75	$ 15.77
First quarter	$ 17.90	$ 16.31
2012:		
Fourth quarter	$ 17.14	$ 14.73
Third quarter	$ 16.81	$ 14.76
Second quarter	$ 17.71	$ 14.84
First quarter	$ 17.67	$ 14.22

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As of February 28, 2014 there were approximately 1,397 shareholders of record of the Company s common stock. On February 28, 2014, the closing sales price was $24.99.

The Company has paid cash dividends on its common stock in every quarter since March 1990, and it is currently the intention of the Board of Directors of the Company to continue payment of cash dividends on a quarterly basis. There is no assurance, however, that any dividends will be paid since they are dependent upon earnings, financial condition and capital requirements of the Company and the Bank. As of December 31, 2013, $44,548,000 was available for payment of dividends by the Bank to the Company, under applicable laws and regulations. The Company paid cash dividends of $0.11 per common share in each of the quarters ended December 31, 2013, September 30, 2013, June 30, 2013, and $0.09 per common share in each of the quarters ended March 31, 2013, December 31, 2012, September 30, 2012, June 30, 2012, and March 31, 2012.

Stock Repurchase Plan

The Company adopted a stock repurchase plan on August 21, 2007 for the repurchase of up to 500,000 shares of the Company s common stock from time to time as market conditions allow. The 500,000 shares authorized for repurchase under this plan represented approximately 3.2% of the Company s approximately 15,815,000 common shares outstanding as of August 21, 2007. This plan has no stated expiration date for the repurchases. As of December 31, 2013, the Company had purchased 166,600 shares under this plan. The following table shows the repurchases made by the Company or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Exchange Act) during the fourth quarter of 2013:

Period	(a) Total number of shares purchased	(b) Average price paid per share	(c) Total number of shares purchased as of part of publicly announced plans or programs	(d) Maximum number shares that may yet be purchased under the plans or programs
Oct. 1-31, 2013				333,400
Nov. 1-30, 2013				333,400
Dec. 1-31, 2013				333,400
Total				333,400

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The following graph presents the cumulative total yearly shareholder return from investing $100 on December 31, 2008, in each of TriCo common stock, the Russell 3000 Index, and the SNL Western Bank Index. The SNL Western Bank Index compiled by SNL Financial includes banks located in California, Oregon, Washington, Montana, Hawaii and Alaska with market capitalization similar to that of TriCo s. The amounts shown assume that any dividends were reinvested.

	Period Ending					
Index	**12/31/08**	**12/31/09**	**12/31/10**	**12/31/11**	**12/31/12**	**12/31/13**
TriCo Bancshares	100.00	68.90	68.46	61.85	74.49	128.61
Russell 3000	100.00	128.34	150.07	151.61	176.49	235.71
SNL Western Bank	100.00	91.83	104.05	94.00	118.63	166.91

Equity Compensation Plans

The following table shows shares reserved for issuance for outstanding options, stock appreciation rights and warrants granted under our equity compensation plans as of December 31, 2013. All of our equity compensation plans have been approved by shareholders.

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans not approved by shareholders			
Equity compensation plans approved by shareholders	1,246,370	$ 18.04	937,500
Total	1,246,370	$ 18.04	937,500

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ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data are derived from our consolidated financial statements. This data should be read in connection with our consolidated financial statements and the related notes located at Item 8 of this report.

TRICO BANCSHARES

Financial Summary

(in thousands, except per share amounts)

Year ended December 31,	2013	2012	2011	2010	2009
Interest income	$ 106,560	$ 108,716	$ 102,982	$ 104,572	$ 112,333
Interest expense	4,696	7,344	10,238	14,133	20,615
Net interest income	101,864	101,372	92,744	90,439	91,718
(Benefit from) provision for loan losses	(715)	9,423	23,060	37,458	31,450
Noninterest income	36,829	37,980	42,813	32,695	30,329
Noninterest expense	93,604	97,998	82,715	77,205	75,450
Income before income taxes	45,804	31,931	29,782	8,471	15,147
Provision for income taxes	18,405	12,937	11,192	2,466	5,185
Net income	$ 27,399	$ 18,994	$ 18,590	$ 6,005	$ 9,962
Earnings per share:					
Basic	$ 1.71	$ 1.19	$ 1.17	$ 0.38	$ 0.63
Diluted	$ 1.69	$ 1.18	$ 1.16	$ 0.37	$ 0.62
Per share:					
Dividends paid	$ 0.42	$ 0.36	$ 0.36	$ 0.40	$ 0.52
Book value at December 31	$ 15.61	$ 14.33	$ 13.55	$ 12.64	$ 12.71
Tangible book value at December 31	$ 14.59	$ 13.30	$ 12.49	$ 11.62	$ 11.71
Average common shares outstanding	16,045	15,988	15,935	15,860	15,783
Average diluted common shares outstanding	16,197	16,052	16,000	16,010	16,011
Shares outstanding at December 31	16,077	16,001	15,979	15,860	15,787
At December 31:					
Loans, net of allowance	$ 1,633,762	$ 1,522,175	$ 1,505,118	$ 1,377,000	$ 1,460,097
Total assets	2,744,066	2,609,269	2,555,597	2,189,789	2,170,520
Total deposits	2,410,483	2,289,702	2,190,536	1,852,173	1,828,512
Other borrowings	6,335	9,197	72,541	62,020	66,753
Junior subordinated debt	41,238	41,238	41,238	41,238	41,238

Shareholders equity	250,946	229,359	216,441	200,397	200,649
Financial Ratios:					
For the year:					
Return on average assets	1.04%	0.75%	0.82%	0.27%	0.48%
Return on average equity	11.34%	8.44%	8.93%	2.94%	4.89%
Net interest margin[1]	4.18%	4.32%	4.43%	4.45%	4.77%
Net loan losses to average loans	0.23%	0.82%	1.37%	2.07%	1.53%
Efficiency ratio [2]	67.32%	70.19%	60.88%	62.49%	61.53%
Average equity to average assets	9.21%	8.91%	9.15%	9.25%	9.73%
At December 31:					
Equity to assets	9.15%	8.79%	8.47%	9.15%	9.24%
Total capital to risk-adjusted assets	14.77%	14.53%	13.94%	14.20%	13.36%

1 Fully taxable equivalent.

2 The sum of fully taxable equivalent net interest income and noninterest income divided by noninterest expense.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

As TriCo Bancshares has not commenced any business operations independent of the Bank, the following discussion pertains primarily to the Bank. Average balances, including such balances used in calculating certain financial ratios, are generally comprised of average daily balances for the Company. Within Management s Discussion and Analysis of Financial Condition and Results of Operations, interest income and net interest income are generally presented on a fully tax-equivalent (FTE) basis. The presentation of interest income and net interest income on a FTE basis is a common practice within the banking industry. Interest income and net interest income are shown on a non-FTE basis in this Item 7 this report, and a reconciliation of the FTE and non-FTE presentations is provided below in the discussion of net interest income.

Critical Accounting Policies and Estimates

The Company s discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those that materially affect the financial statements and are related to the adequacy of the allowance for loan losses, investments, mortgage servicing rights, fair value measurements, retirement plans and intangible assets. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The Company s policies related to estimates on the allowance for loan losses, other than temporary impairment of investments and impairment of intangible assets, can be found in Note 1 in the financial statements at Item 8 of this report.

Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances for the Company. Within Management s Discussion and Analysis of Financial Condition and Results of Operations, certain performance measures including interest income, net interest income, net interest yield, and efficiency ratio are generally presented on a fully tax-equivalent (FTE) basis. The Company believes the use of these non-generally accepted accounting principles (non-GAAP) measures provides additional clarity in assessing its results.

On January 21, 2014, TriCo announced that it had entered into an Agreement and Plan of Merger and Reorganization under which it would acquire North Valley Bancorp. North Valley Bancorp shareholders will receive a fixed exchange ratio of 0.9433 shares of TriCo common stock for each share of North Valley Bancorp common stock, which would provide North Valley Bancorp shareholders with aggregate ownership, on a pro forma basis, of approximately 28.6% of the common stock of the combined company. Based on TriCo s closing stock price of $27.66 on January 17, 2014, North Valley Bancorp shareholders would have received consideration valued at approximately $26.09 per share.

The Merger will not be completed unless a number of customary closing conditions are met, including, among others, approval of the merger by shareholders of both companies, the registration of the offering of the TriCo common stock to the North Valley Bancorp shareholders under the Securities Act of 1933, receipt of required regulatory and other approvals and the expiration of applicable statutory waiting periods, the accuracy of specified representations and warranties of each party, the receipt of tax opinions confirming certain tax aspects of the merger, North Valley Bancorp s satisfaction of certain financial measures shortly prior to closing, and the absence of any injunctions or other legal restraints.

TriCo has agreed to appoint three North Valley Bancorp directors to TriCo s board upon closing of the Merger. The Merger is expected to be completed in the second or third quarter of 2014, subject to approval of the Merger by shareholders of both companies, receipt of required regulatory and other approvals and satisfaction of customary closing conditions.

North Valley, headquartered in Redding, California, is the parent of North Valley Bank and had approximately $917.8 million in assets and 22 commercial banking offices in Shasta, Humboldt, Del Norte, Mendocino, Yolo, Sonoma, Placer and Trinity Counties in Northern California at December 31, 2013. In connection with the acquisition, North Valley Bank will merge into the Bank.

As of December 31, 2013, on a pro forma consolidated basis with North Valley Bancorp, TriCo would have had approximately $3.61 billion in assets.

On September 23, 2011, the California DBO closed Citizens Bank of Northern California (Citizens), Nevada City, California and appointed the FDIC as receiver. That same date, the Bank assumed the banking operations of Citizens from the FDIC under a whole bank purchase and assumption agreement without loss sharing. With this agreement, the Bank added seven traditional bank branches including two in Grass Valley, and one in each of Nevada City, Penn Valley, Lake of the Pines, Truckee, and Auburn, California. This acquisition is consistent with the Bank s community banking expansion strategy and provides further opportunity to fill in the Bank s market presence in the Northern California market.

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On May 28, 2010, the Office of the Comptroller of the Currency closed Granite Community Bank (Granite), Granite Bay, California and appointed the FDIC as receiver. That same date, the Bank assumed the banking operations of Granite from the FDIC under a whole bank purchase and assumption agreement with loss sharing. Under the terms of the loss sharing agreement, the FDIC will cover a substantial portion of any future losses on loans, related unfunded loan commitments, other real estate owned (OREO)/foreclosed assets and accrued interest on loans for up to 90 days. The FDIC will absorb 80% of losses and share in 80% of loss recoveries on the covered assets acquired from Granite. The loss sharing arrangements for non-single family residential and single family residential loans are in effect for 5 years and 10 years, respectively, and the loss recovery provisions are in effect for 8 years and 10 years, respectively, from the acquisition date. With this agreement, the Bank added one traditional bank branch in each of Granite Bay and Auburn, California. This acquisition is consistent with the Bank s community banking expansion strategy and provides further opportunity to fill in the Bank s market presence in the greater Sacramento, California market.

The Company refers to loans and foreclosed assets that are covered by loss sharing agreements as covered loans and covered foreclosed assets , respectively. In addition, the Company refers to loans purchased or obtained in a business combination as purchased credit impaired (PCI) loans, or purchased not credit impaired (PNCI) loans. The Company refers to loans that it originates as originated loans. Additional information regarding the Citizens acquisition can be found in Note 2 in the financial statements at Item 8 of this report. Additional information regarding the definitions and accounting for originated, PNCI and PCI loans can be found in Notes 1, 2, 4 and 5 in the financial statements at Item 8 of this report, and under the heading *Asset Quality and Non-Performing Assets* below.

Geographical Descriptions

For the purpose of describing the geographical location of the Company s loans, the Company has defined northern California as that area of California north of, and including, Stockton; central California as that area of the State south of Stockton, to and including, Bakersfield; and southern California as that area of the State south of Bakersfield.

Results of Operations

Overview

The following discussion and analysis is designed to provide a better understanding of the significant changes and trends related to the Company and the Bank s financial condition, operating results, asset and liability management, liquidity and capital resources and should be read in conjunction with the consolidated financial statements of the Company and the related notes at Item 8 of this report.

Following is a summary of the components of net income for the periods indicated (dollars in thousands):

	Year ended December 31,		
	2013	2012	2011
Components of Net Income			
Net interest income	$ 101,864	$ 101,372	$ 92,744
Benefit from (provision for) loan losses	715	(9,423)	(23,060)
Noninterest income	36,829	37,980	42,813
Noninterest expense	(93,604)	(97,998)	(82,715)
Taxes	(18,405)	(12,937)	(11,192)

Net income	$ 27,399	$ 18,994	$ 18,590
Net income per average fully-diluted share	$ 1.69	$ 1.18	$ 1.16
Net income as a percentage of average shareholders equity	11.34%	8.44%	8.93%
Net income as a percentage of average total assets	1.04%	0.75%	0.82%

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Net Interest Income

The Company s primary source of revenue is net interest income, which is the difference between interest income on earning assets and interest expense on interest-bearing liabilities.

Following is a summary of the Company s net interest income for the periods indicated (dollars in thousands):

	Year ended December 31,		
	2013	2012	2011
Components of Net Interest Income			
Interest income	$ 106,560	$ 108,716	$ 102,982
Interest expense	(4,696)	(7,344)	(10,238)
Net interest income	101,864	101,372	92,744
FTE adjustment	350	257	309
Net interest income (FTE)	$ 102,214	$ 101,629	$ 93,053
Net interest margin (FTE)	4.18%	4.32%	4.43%

Net interest income (FTE) for the year ended December 31, 2013 was $102,214,000, an increase of $585,000 or 0.6% compared to the year ended December 31, 2012. The increase in net interest income during 2013 when compared to 2012 is mainly due to a decrease in average balance of other borrowings, a shift in deposit balances from relatively high interest rate earning time deposits to noninterest-earning, demand, and savings deposits, an increase in the average balance of investments securities, and an increase in the average balance of loans; all of which were substantially offset by a decrease in the average yield on loans. The Yield and Volume/Rate tables shown below are useful in illustrating and quantifying the developments that affected net interest income during 2013.

Net interest income (FTE) for the year ended December 31, 2012 was $101,629,000, an increase of $8,576,000 or 9.2% compared to the year ended December 31, 2011. The increase in net interest income during 2012 when compared to 2011 is mainly due to the acquisition of Citizens on September 23, 2011 and its associated net interest income of $17,852,000 during 2012 compared to $6,117,000 from the acquisition date of September 23, 2011 to December 31, 2011. Included in the net interest income associated with the Citizens acquisition is $7,572,000 and $3,146,000 from the accretion of loan purchase discounts during 2012 and 2011, respectively. Also contributing to the increase in net interest income was a reduction in deposit rates, the flow of deposits from relatively higher paying time deposits to lower paying non-maturity deposits, and the reduction of relatively high cost other borrowings. During 2012, investment opportunities continued to be unattractive given their low market yields and interest rate risk profile. The Yield and Volume/Rate tables shown below are useful in illustrating and quantifying the developments that affected net interest income during 2012.

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Summary of Average Balances, Yields/Rates and Interest Differential Yield Tables

The following tables present, for the periods indicated, information regarding the Company s consolidated average assets, liabilities and shareholders equity, the amounts of interest income from average earning assets and resulting yields, and the amount of interest expense paid on interest-bearing liabilities. Average loan balances include nonperforming loans. Interest income includes proceeds from loans on nonaccrual loans only to the extent cash payments have been received and applied to interest income. Yields on securities and certain loans have been adjusted upward to reflect the effect of income thereon exempt from federal income taxation at the current statutory tax rate (dollars in thousands):

	Year ended December 31, 2013		
	Average balance	Interest income/expense	Rates earned/paid
Assets			
Loans	$ 1,610,725	$ 97,548	6.06%
Investment securities - taxable	224,636	6,736	3.00%
Investment securities - nontaxable	16,632	933	5.61%
Cash at Federal Reserve and other banks	591,507	1,693	0.29%
Total earning assets	2,443,500	106,910	4.38%
Other assets	179,267		
Total assets	$ 2,622,767		
Liabilities and shareholders equity			
Interest-bearing demand deposits	$ 524,139	528	0.10%
Savings deposits	797,803	1,026	0.13%
Time deposits	315,253	1,891	0.60%
Other borrowings	8,026	4	0.05%
Junior subordinated debt	41,238	1,247	3.02%
Total interest-bearing liabilities	1,686,459	4,696	0.28%
Noninterest-bearing demand	657,377		
Other liabilities	37,297		
Shareholders equity	241,634		
Total liabilities and shareholders equity	$ 2,622,767		
Net interest spread [1]			4.10%
Net interest income and interest margin [2]		$ 102,214	4.18%

(1)

Net interest spread represents the average yield earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

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

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Summary of Average Balances, Yields/Rates and Interest Differential Yield Tables (continued)

	Year ended December 31, 2012		
	Average balance	Interest income/ expense	Rates earned/paid
Assets			
Loans	$ 1,552,540	$ 100,496	6.47%
Investment securities - taxable	200,958	6,177	3.07%
Investment securities - nontaxable	9,529	685	7.19%
Cash at Federal Reserve and other banks	587,118	1,615	0.28%
Total earning assets	2,350,145	108,973	4.64%
Other assets	176,927		
Total assets	$ 2,527,072		
Liabilities and shareholders equity			
Interest-bearing demand deposits	$ 471,747	784	0.17%
Savings deposits	763,065	1,212	0.16%
Time deposits	372,698	2,420	0.65%
Other borrowings	45,753	1,604	3.51%
Junior subordinated debt	41,238	1,324	3.21%
Total interest-bearing liabilities	1,694,501	7,344	0.43%
Noninterest-bearing demand	572,568		
Other liabilities	34,852		
Shareholders equity	225,151		
Total liabilities and shareholders equity	$ 2,527,072		
Net interest spread (1)			4.21%
Net interest income and interest margin (2)		$ 101,629	4.32%

	Year ended December 31, 2011		
	Average balance	Interest income/ expense	Rates earned/paid
Assets			
Loans	$ 1,442,821	$ 92,691	6.42%
Investment securities - taxable	262,306	8,760	3.34%
Investment securities - nontaxable	11,403	833	7.31%

Cash at Federal Reserve and other banks	386,067	1,007	0.26%
Total earning assets	2,102,597	103,291	4.91%
Other assets	173,311		
Total assets	$ 2,275,908		
Liabilities and shareholders equity			
Interest-bearing demand deposits	$ 410,870	$ 1,217	0.30%
Savings deposits	661,480	1,421	0.21%
Time deposits	415,319	3,921	0.94%
Other borrowings	63,602	2,420	3.80%
Junior subordinated debt	41,238	1,259	3.05%
Total interest-bearing liabilities	1,592,509	10,238	0.64%
Noninterest-bearing demand	442,174		
Other liabilities	33,005		
Shareholders equity	208,220		
Total liabilities and shareholders equity	$ 2,275,908		
Net interest spread (1)			4.27%
Net interest income and interest margin (2)		$ 93,053	4.43%

(1) Net interest spread represents the average yield earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

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

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Summary of Changes in Interest Income and Expense due to Changes in Average Asset and Liability Balances and Yields Earned and Rates Paid Volume/Rate Tables

The following table sets forth a summary of the changes in the Company s interest income and interest expense from changes in average asset and liability balances (volume) and changes in average interest rates for the periods indicated. The rate/volume variance has been included in the rate variance. Amounts are calculated on a fully taxable equivalent basis:

	2013 over 2012			2012 over 2011		
	Volume	Yield/ Rate	Total	Volume	Yield/ Rate	Total
	(dollars in thousands)					
Increase (decrease) in interest income:						
Loans	$ 3,765	$ (6,713)	$ (2,948)	$ 7,044	$ 761	$ 7,805
Investments - taxable	727	(168)	559	(2,049)	(534)	(2,583)
Investments - nontaxable	511	(263)	248	(137)	(11)	(148)
Cash at Federal Reserve and other banks	12	66	78	523	85	608
Total	5,015	(7,078)	(2,063)	5,381	301	5,682
Increase (decrease) in interest expense:						
Demand deposits (interest-bearing)	89	(345)	(256)	183	(616)	(433)
Savings deposits	56	(242)	(186)	213	(422)	(209)
Time deposits	(373)	(156)	(529)	(401)	(1,100)	(1,501)
Other borrowings	(1,324)	(276)	(1,600)	(678)	(138)	(816)
Junior subordinated debt		(77)	(77)		65	65
Total	(1,552)	(1,096)	(2,648)	(683)	(2,211)	(2,894)
Increase (decrease) in net interest income	$ 6,567	$ (5,982)	$ 585	$ 6,064	$ 2,512	$ 8,576

Provision for Loan Losses

The provision for loan losses during any period is the sum of the allowance for loan losses required at the end of the period and any loan charge offs during the period, less the allowance for loan losses required at the beginning of the period, and less any loan recoveries during the period. See the Tables labeled *Allowance for loan losses year ended December 31, 2013 and 2012* at Note 5 in Item 8 of Part II of this report for the components that make up the provision for loan losses for the years ended December 31, 2013 and 2012.

The Company benefited from a $715,000 reversal of provision for loan losses during the year ended December 31, 2013 versus a provision for loan losses of $9,423,000 during the year ended December 31, 2012. As shown in the Table labeled *Allowance for Loan Losses year ended December 31, 2013* at Note 5 in Item 8 of Part II of this report, residential real estate mortgage loans, home equity lines of credit and auto indirect loans experienced a reversal of provision for loan losses during the year ended December 31, 2013. All other categories of loans experienced a provision for loan losses during the year ended December 31, 2013. The level of provision, or reversal of provision, for loan losses of each loan category during the year ended December 31, 2013 was due primarily to a decrease in the required allowance for loan losses as of December 31, 2013 when compared to the required allowance for loan losses as of December 31, 2012 less net charge-offs during the year ended December 31, 2013, and the effect of the changes in the allowance methodology during the year ended December 31, 2013 as described under the heading *Loans and Allowance for Loan Losses* at Note 1 in Item 8 of Part II of this report. All categories of loans except commercial real estate mortgage loans, home equity loans, and residential construction loans experienced a decrease in the required allowance for loan losses during the year ended December 31, 2013. These decreases in required allowance for loan losses were due primarily to reduced impaired loans, improvements in estimated cash flows and collateral values for the remaining and newly impaired loans, and reductions in historical loss factors that, in part, determine the required loan loss allowance for performing loans in accordance with the Company s allowance for loan losses methodology as described under the heading *Loans and Allowance for Loan Losses* at Note 1 in Item 8 of Part II of this report. These same factors were also present, to some extent, for commercial real estate mortgage loans, home equity loans, and residential construction loans, but were more than offset by the effect of increased loan balances or changes in credit quality within the pass category of these loan categories resulting in net provisions for loan losses in these categories during the year ended December 31, 2013. For details of the change in nonperforming loans during the year ended December 31, 2013 see the Tables, and associated narratives, labeled *Changes in nonperforming assets during the year ended December 31, 2013* and *Changes in nonperforming assets during the three months ended December 31, September 30, June 30, and March 31, 2013* under the heading *Asset Quality and Non-Performing Assets* below. During the year ended December 31, 2013, the Company made several changes to its allowance for loan loss methodology. The changes in methodology are described under the heading *Allowance for loan losses* in the section below labeled *Financial Condition* . Excluding the effect of the changes in allowance methodology during the year ended December 31, 2013, the reversal of provision for loan losses during the year ended December 31, 2013 would have been approximately $4,188,000, or $3,473,000 more than the $715,000 that was actually recorded, and the allowance for loan losses at December 31, 2013 would have been approximately $34,772,000, or $3,473,000 less than the $38,245,000 that was actually recorded.

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The provision for loan losses was $9,423,000 and $23,060,000 for the years ended December 31, 2012, and 2011, respectively. The decrease in the provision for loan losses for the year ended December 31, 2012 as compared to the year ended December 31, 2011 was primarily the result of improvement in collateral values and estimated cash flows related to nonperforming loans and purchased credit impaired loans, and a reduction in nonperforming loans.

The provision for loan losses related to Originated and PNCI loans is based on management s evaluation of inherent risks in these loan portfolios and a corresponding analysis of the allowance for loan losses. The provision for loan losses related to PCI loan portfolio is based on changes in estimated cash flows expected to be collected on PCI loans. Additional discussion on loan quality, our procedures to measure loan impairment, and the allowance for loan losses is provided under the heading *Asset Quality and Non-Performing Assets* below.

Management re-evaluates the loss ratios and other assumptions used in its calculation of the allowance for loan losses for its Originated and PNCI loan portfolios on a quarterly basis and makes changes as appropriate based upon, among other things, changes in loss rates experienced, collateral support for underlying loans, changes and trends in the economy, and changes in the loan mix. Management also re-evaluates expected cash flows used in its accounting for its PCI loan portfolio, including any required allowance for loan losses, on a quarterly basis and makes changes as appropriate based upon, among other things, changes in loan repayment experience, changes in loss rates experienced, and collateral support for underlying loans.

Noninterest Income

The following table summarizes the Company s noninterest income for the periods indicated (dollars in thousands):

	Year ended December 31,		
	2013	2012	2011
Components of Noninterest Income			
Service charges on deposit accounts	$ 12,716	$ 14,290	$ 14,776
ATM fees and interchange	8,370	7,762	7,058
Other service fees	2,144	2,223	1,722
Mortgage banking service fees	1,774	1,666	1,495
Change in value of mortgage servicing rights	253	(2,016)	(1,107)
Total service charges and fees	25,257	23,925	23,944
Gain on sale of loans	5,602	6,810	3,037
Commissions on sale of nondeposit investment products	2,983	3,209	2,105
Increase in cash value of life insurance	1,727	1,820	1,885
Change in indemnification asset	(1,649)	(286)	2,059
Gain on disposition of foreclosed assets	1,640	786	680
Bargain purchase gain			7,575
Gain on life insurance death benefit		675	789
Other noninterest income	1,269	1,041	739
Total noninterest income	$ 36,829	$ 37,980	$ 42,813

Noninterest income decreased $1,151,000 (3.0%) to $36,829,000 in 2013. Service charges on deposit accounts were down $1,574,000 (11.0%) due to reduced customer overdrafts and a resulting decrease in non-sufficient funds fees.

ATM fees and interchange income was up $608,000 (7.8%) due to increased customer point-of-sale transactions that are primarily the result of incentives for such usage. Overall, mortgage banking activities, which includes mortgage banking servicing fees, change in value of mortgage servicing rights, and gain on sale of loans, accounted for $7,629,000 of noninterest income in the 2013 compared to $6,460,000 in 2012. This $1,169,000 (18.1%) increase in mortgage banking related revenue is mainly due to historically low mortgage rates and the associated high level of mortgage refinance activity that existed during most of 2013, the Bank s focus of resources in this area, and an increase in mortgage rates in the second half of 2013 that while significantly decreasing originations, sales, and gain on sale of loans during the second half of 2013, also resulted in an increase in the value of the Company s mortgage servicing rights during 2013. Commissions on sale of nondeposit investment products decreased $226,000 (7.0%) in 2013. The change in indemnification asset from ($286,000) in 2012 to ($1,649,000) in 2013 is primarily due to a decrease in estimated loan losses from the loan portfolio and foreclosed assets acquired in the Granite acquisition on May 28, 2010, and the fact that such losses are generally covered at the rate of 80% by the FDIC. The decrease in estimated losses is also reflected in increased interest income, decreased provision for loan losses and/or decreased provision for foreclosed asset losses.

Noninterest income decreased $4,833,000 (11.3%) to $37,980,000 in 2012. Excluding bargain purchase gains and gain on life insurance death benefits, noninterest income would have increased $2,856,000 (8.3%) to $37,305,000 in 2012 from $34,449,000 in 2011. Service charges on deposit accounts were down $486,000 (3.3%) due to reduced customer overdrafts and a resulting decrease in non-sufficient funds fees. ATM fees and interchange income was up $704,000 (10.0%) due to increased customer point-of-sale transactions that are the result of incentives for such usage. Overall, mortgage banking activities, which includes mortgage banking servicing fees, change in value of mortgage servicing rights, and gain on sale of loans, accounted for $6,460,000 of noninterest income in the 2012 compared to $3,425,000 in 2011. This $3,035,00 (88.6%) increase in mortgage banking related revenue is mainly due to historically low mortgage rates, an associated level of mortgage refinance activity, and the Bank s focus of resources in this area. Commissions on sale of nondeposit investment products increased $1,104,000 (52.4%) in 2012 due to the Bank s focus of resources in this area. The change in indemnification asset from $2,059,000 in 2011 to ($286,000) in 2012 is primarily due to a decrease in estimated loan losses from the loan portfolio and foreclosed assets acquired in the Granite acquisition on May 28, 2010, and the fact that such losses are generally covered at the rate of 80% by the FDIC. The actual decrease in estimated losses is reflected in increased interest income, decreased provision for loan losses and/or decreased provision for foreclosed asset losses. The operations of Citizens added $2,585,000 to noninterest income during 2012.

Noninterest Expense

The following table summarizes the Company s other noninterest expense for the periods indicated (dollars in thousands):

	Year ended December 31,		
	2013	2012	2011
Components of Noninterest Expense			
Salaries and related benefits:			
Base salaries, net of deferred loan origination costs	$ 34,404	$ 33,093	$ 29,753
Incentive compensation	4,694	5,138	3,735
Benefits and other compensation costs	12,838	11,721	10,715
Total salaries and related benefits	51,936	49,952	44,203
Other noninterest expense:			
Occupancy	7,405	7,263	6,198
Equipment	4,162	4,444	3,770
Data processing and software	4,844	4,793	3,980
Assessments	2,248	2,393	2,491
ATM network charges	2,480	2,390	1,939
Advertising	1,981	2,876	2,649
Professional fees	3,019	2,879	2,004
Telecommunications	2,449	2,250	1,875
Postage	786	920	935
Courier service	988	1,013	953
Foreclosed asset expense	514	1,474	755
Intangible amortization	209	209	177
Operational losses	618	787	600
Provision for foreclosed asset losses	682	1,728	1,984
Change in reserve for unfunded commitments	(1,200)	875	100
Legal settlement	339	2,090	
Other	10,144	9,662	8,102
Total other noninterest expenses	41,668	48,046	38,512

Total noninterest expense	$ 93,604	$ 97,998	$ 82,715
Average full time equivalent staff	733	737	687
Noninterest expense to revenue (FTE)	67.3%	70.2%	60.9%

Salary and benefit expenses increased $1,984,000 (4.0%) to $51,936,000 during the year ended December 31, 2013 compared to the year ended December 31, 2012. Base salaries increased $1,311,000 (4.0%) to $34,404,000 during the year ended December 31, 2013. The increase in base salaries was mainly due to annual merit increases and an increase in administrative, central operations, and electronic banking personnel that were partially offset by a reduction in branch personnel. Average full time equivalent personnel decreased to 733 during the year ended December 31, 2013 from 737 during the year ended December 31, 2012. Incentive and commission related salary expenses decreased $444,000 (8.6%) to $4,694,000 during year ended December 31, 2013 due primarily to reduced mortgage loan production incentives when compared to the prior year. Benefits expense, including retirement, medical and workers compensation insurance, and taxes, increased $1,117,000 (9.5%) to $12,838,000 during the year ended December 31, 2013 primarily due to increased medical insurance costs, employee stock ownership plan expense, and employer payroll taxes.

Salary and benefit expenses increased $5,749,000 (13.0%) to $49,952,000 in 2012 compared to 2011. Base salaries increased $3,340,000 (11.2%) to $33,093,000 in 2012. The increase in base salaries was mainly due to a 50 FTE (7.3%) increase in average full time equivalent staff to 737 during 2012, and annual merit increases. Incentive and commission related salary expenses increased $1,403,000 (37.6%) to $5,138,000 in 2012 due primarily to increases in commissions related to loan production and nondeposit investment product fee production. Benefits expense, including retirement, medical and workers compensation insurance, and taxes, increased $1,006,000 (9.4%) to $11,721,000 during 2012. The operations of Citizens added $2,452,000 and $751,000 to salaries and benefits expense for the year ended December 31, 2012, and the period from September 23, 2011 to December 31, 2011, respectively.

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Other noninterest expenses decreased $6,378,000 (13.3%) to $41,668,000 during the year ended December 31, 2013 when compared to the year ended December 31, 2012. The decrease in other noninterest expense is primarily due to decreases of $2,075,000, $1,751,000, $1,046,000, $960,000, and $895,000 in change in reserve for unfunded commitments, legal settlement expense, provision for foreclosed asset losses, foreclosed asset expenses, and advertising and marketing expense, respectively, from the prior year. The decrease in change in reserve for unfunded commitments was mainly due to improved loss histories for performing originated loans that are used to calculate the required reserve for unfunded commitments. The decrease in legal settlement expense is due to the resolution of a legal proceeding, and is further described at Item 3 of Part I of this report. The decreases in provision for foreclosed asset losses and foreclosed asset expense are due to decreased foreclosed assets, and improved values of foreclosed values. During 2013, the Bank opened no branches, closed three (leased) branches, closed one (leased) non-branch facility, and opened its Campus (owned) facility.

Other noninterest expenses increased $9,534,000 (24.8%) to $48,046,000 in 2012. The operations of Citizens added $3,333,000 to other noninterest expense during 2012, compared to $1,114,000 from September 23, 2011 to December 31, 2011. Changes in the various categories of other noninterest expense are reflected in the table above. The changes from 2011 to 2012 are indicative of the economic environment which lead to increases in professional loan collection expenses, provision for foreclosed asset losses, and foreclosed asset expenses. Occupancy expense increased primarily due to seven branches and one admin facility acquired in the Citizens acquisition on September 23, 2011. The increase in change in reserve for unfunded commitments during 2012 is primarily due to increased unfunded construction loan commitments during the three months ended December 31, 2012. During 2012, the Bank opened one (leased) branch, and closed two (leased) branches.

Income Taxes

The effective tax rate on income was 40.2%, 40.5%, and 37.6% in 2013, 2012, and 2011, respectively. The effective tax rate was greater than the federal statutory tax rate due to state tax expense of $4,811,000, $3,277,000, and $2,845,000, respectively, in these years. Tax-exempt income of $583,000, $428,000, and $514,000, respectively, from investment securities, and $1,727,000, $2,495,000, and $2,674,000, respectively, from increase in cash value and gain on death benefit of life insurance in these years helped to reduce the effective tax rate.

Financial Condition

Investment Securities

The following table presents the available for sale investment securities portfolio by major type as of the dates indicated:

	Year ended December 31,				
(In thousands)	2013	2012	2011	2010	2009
Investment securities available for sale (at fair value):					
Obligations of US government corporations and agencies	$ 97,143	$ 151,701	$ 217,384	$ 264,181	$ 193,130
Obligations of states and political subdivisions	5,589	9,421	10,028	12,541	17,953
Corporate bonds	1,915	1,905	1,811	549	539
Total investment securities available for sale	$ 104,647	$ 163,027	$ 229,223	$ 277,271	$ 211,622

Investment securities available for sale decreased $58,380,000 to $104,647,000 as of December 31, 2013, as compared to December 31, 2012. This decrease is attributable to maturities and principal repayments of $53,468,000, a decrease in fair value of investments securities available for sale of $4,233,000, and amortization of net purchase price premiums of $679,000.

The following table presents the held to maturity investment securities portfolio by major type as of the dates indicated:

	Year ended December 31,				
(In thousands)	2013	2012	2011	2010	2009
Investment securities held to maturity (at cost):					
Obligations of US government corporations and agencies	$ 227,864				
Obligations of states and political subdivisions	12,640				
Total investment securities held to maturity	$ 240,504				

Investment securities held to maturity increased to $240,504,000 as of December 31, 2013, as compared to December 31, 2012. This increase is attributable to purchases of $244,967,000, less principal repayments of $4,391,000, and amortization of net purchase price discounts/premiums of $72,000.

Additional information about the investment portfolio is provided in Note 3 in the financial statements at Item 8 of Part II of this report.

Restricted Equity Securities

Restricted equity securities were $9,163,000 at December 31, 2013 and $9,647,000 at December 31, 2012. The entire balance of restricted equity securities at December 31, 2013 and December 31, 2012 represents the Bank s investment in the Federal Home Loan Bank of San Francisco (FHLB). The decrease of $484,000 is attributable to the redemption of $484,000 of FHLB stock.

FHLB stock is carried at par and does not have a readily determinable fair value. While technically these are considered equity securities, there is no market for the FHLB stock. Therefore, the shares are considered as restricted investment securities. Management periodically evaluates FHLB stock for other-than-temporary impairment. Management s determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB.

As a member of the FHLB system, the Company is required to maintain a minimum level of investment in FHLB stock based on specific percentages of its outstanding mortgages, total assets, or FHLB advances. The Company may request redemption at par value of any stock in excess of the minimum required investment. Stock redemptions are at the discretion of the FHLB.

Loans

The Bank concentrates its lending activities in four principal areas: real estate mortgage loans (residential and commercial loans), consumer loans, commercial loans (including agricultural loans), and real estate construction loans. The interest rates charged for the loans made by the Bank vary with the degree of risk, the size and maturity of the loans, the borrower s relationship with the Bank and prevailing money market rates indicative of the Bank s cost of funds.

The majority of the Bank s loans are direct loans made to individuals, farmers and local businesses. The Bank relies substantially on local promotional activity and personal contacts by bank officers, directors and employees to compete with other financial institutions. The Bank makes loans to borrowers whose applications include a sound purpose, a viable repayment source and a plan of repayment established at inception and generally backed by a secondary source of repayment.

Loan Portfolio Composite

The following table shows the Company s loan balances, including net deferred loan costs, at the dates indicated:

	Year ended December 31,				
(dollars in thousands)	2013	2012	2011	2010	2009
Real estate mortgage	$ 1,107,863	$ 1,010,130	$ 965,922	$ 835,471	$ 844,053
Consumer	383,163	386,111	406,330	395,771	428,722
Commercial	131,878	135,528	139,131	143,413	164,094

Real estate construction	49,103	33,054	39,649	44,916	58,701
Total loans	$ 1,672,007	$ 1,564,823	$ 1,551,032	$ 1,419,571	$ 1,495,570

The following table shows the Company s loan balances, including net deferred loan costs, as a percentage of total loans at the dates indicated:

	Year ended December 31,				
	2013	2012	2011	2010	2009
Real estate mortgage	66.3%	64.5%	62.2%	58.8%	56.4%
Consumer	22.9%	24.7%	26.2%	27.9%	28.7%
Commercial	7.9%	8.7%	9.0%	10.1%	11.0%
Real estate construction	2.9%	2.1%	2.6%	3.2%	3.9%
Total loans	100.0%	100.0%	100.0%	100.0%	100.0%

At December 31, 2013 loans, including net deferred loan costs, totaled $1,672,007,000 which was a 6.8% ($107,184,000) increase over the balances at the end of 2012. Demand for commercial real estate (real estate mortgage) loans was weak to modest during 2013. During 2013, the Company purchased $62,698,000 of residential (real estate mortgage) loans. Demand for home equity loans and lines of credit were weak during 2013. Real estate construction loans increased during 2013 primarily due to one large loan that was originated during 2013.

At December 31, 2012 loans, including net deferred loan costs, totaled $1,564,823,000 which was a 0.9% ($13,791,000) increase over the balances at the end of 2011. Demand for commercial real estate (real estate mortgage) loans was weak to modest during 2012. Demand for home equity loans and lines of credit were weak during 2012. Real estate construction loans declined during 2012 as did auto dealer loans.

At December 31, 2011 loans, including net deferred loan costs, totaled $1,551,032,000 which was a 9.3% ($131,461,000) increase over the balances at the end of 2010. This increase in loans during 2011 included $167,484,000 of loans acquired in the Citizens acquisition on September 23, 2011. Demand for commercial real estate (real estate mortgage) loans was weak during 2011. Demand for home equity loans and lines of credit was weak to modest during 2011. Real estate construction loans declined during 2011 as did auto dealer loans.

Asset Quality and Nonperforming Assets

Nonperforming Assets

Loans originated by the Company, i.e., not purchased or acquired in a business combination, are referred to as originated loans. Originated loans are reported at the principal amount outstanding, net of deferred loan fees and costs. Loan origination and commitment fees and certain direct loan origination costs are deferred, and the net amount is amortized as an adjustment of the related loan s yield over the actual life of the loan. Originated loans on which the accrual of interest has been discontinued are designated as nonaccrual loans.

Originated loans are placed in nonaccrual status when reasonable doubt exists as to the full, timely collection of interest or principal, or a loan becomes contractually past due by 90 days or more with respect to interest or principal and is not well secured and in the process of collection. When an originated loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of Management, the loan is estimated to be fully collectible as to both principal and interest.

An allowance for loan losses for originated loans is established through a provision for loan losses charged to expense. Originated loans and deposit related overdrafts are charged against the allowance for loan losses when Management believes that the collectability of the principal is unlikely or, with respect to consumer installment loans, according to an established delinquency schedule. The allowance is an amount that Management believes will be adequate to absorb probable losses inherent in existing loans and leases, based on evaluations of the collectability, impairment and prior loss experience of loans and leases. The evaluations take into consideration such factors as changes in the nature and size of the portfolio, overall portfolio quality, loan concentrations, specific problem loans, and current economic conditions that may affect the borrower s ability to pay. The Company defines an originated loan as impaired when it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired originated loans are measured based on the present value of expected future cash flows discounted at the loan s original effective interest rate. As a practical expedient, impairment may be measured based on the loan s observable market price or the fair value of the collateral if the loan is collateral dependent. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through a valuation allowance.

In situations related to originated loans where, for economic or legal reasons related to a borrower s financial difficulties, the Company grants a concession for other than an insignificant period of time to the borrower that the Company would not otherwise consider, the related loan is classified as a troubled debt restructuring (TDR). The Company strives to identify borrowers in financial difficulty early and work with them to modify to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where the Company grants the borrower new terms that result in the loan being classified as a TDR, the Company measures any impairment on the restructuring as noted above for impaired loans. TDR loans are classified as impaired until they are fully paid off or charged off. Loans that are in nonaccrual status at the time they become TDR loans, remain in nonaccrual status until the borrower demonstrates a sustained period of performance which the Company generally believes to be six consecutive months of payments, or equivalent. Otherwise, TDR loans are subject to the same nonaccrual and charge-off policies as noted above with respect to their restructured principal balance.

Credit risk is inherent in the business of lending. As a result, the Company maintains an allowance for loan losses to absorb losses inherent in the Company s originated loan portfolio. This is maintained through periodic charges to earnings. These charges are included in the Consolidated Statements of Income as provision for loan losses. All specifically identifiable and quantifiable losses are immediately charged off against the allowance. However, for a variety of reasons, not all losses are immediately known to the Company and, of those that are known, the full extent of the loss may not be quantifiable at that point in time. The balance of the Company s allowance for originated loan losses is meant to be an estimate of these unknown but probable losses inherent in the portfolio.

The Company formally assesses the adequacy of the allowance for originated loan losses on a quarterly basis. Determination of the adequacy is based on ongoing assessments of the probable risk in the outstanding originated loan portfolio, and to a lesser extent the Company s originated loan commitments. These assessments include the periodic re-grading of credits based on changes in their individual credit characteristics including delinquency, seasoning, recent financial performance of the borrower, economic factors, changes in the interest rate environment, growth of the portfolio as a whole or by segment, and other factors as warranted. Loans are initially graded when originated. They are re-graded as they are renewed, when there is a new loan to the same borrower, when identified facts demonstrate heightened risk of nonpayment, or if they become delinquent. Re-grading of larger problem loans occurs at least quarterly. Confirmation of the quality of the grading process is obtained by independent credit reviews conducted by consultants specifically hired for this purpose and by various bank regulatory agencies.

The Company s method for assessing the appropriateness of the allowance for originated loan losses includes specific allowances for impaired originated loans and leases, formula allowance factors for pools of credits, and allowances for changing environmental factors (e.g., interest rates, growth, economic conditions, etc.). Allowance factors for loan pools were based on historical loss experience by product type and prior risk rating.

During the three months ended March 31, 2012, management changed some of the assumptions utilized in the Allowance for Loan Losses estimate calculation. These changes were intended to more accurately reflect the current risk in the loan portfolio and to better estimate the losses inherent but not yet quantifiable. These changes included the conversion to a historical loss migration analysis intended to better determine the appropriate formula reserve ratio by loan category and risk rating, the addition of an environmental factor related to the delinquency rate of loans not classified as impaired by loan category, the elimination of an unspecified reserve allocation previously intended to account for imprecision inherent in the overall calculation, and the reclassification of risk rating of certain consumer loans based on current credit score in an attempt to better identify the risk in the portfolio. The financial effect of these changes resulted in a net reduction in the calculated Allowance for Loan Losses of $1,388,000 during the three months ended March 31, 2012. Allowances for impaired loans are based on analysis of individual credits. Allowances for changing environmental factors are Management s best estimate of the probable impact these changes have had on the originated loan portfolio as a whole. The allowance for originated loans is included in the allowance for loan losses.

During the three months ended March 31, 2013, the Company changed the method it uses to estimate net sale proceeds from real estate collateral sales when calculating the allowance for loan losses associated with impaired real estate collateral dependent loans. Previously, the Company used the greater of fifteen percent or actual estimated selling costs. Currently, the Company uses the actual estimated selling costs, and an adjustment to appraised value based on the age of the appraisal. These changes are intended to more accurately reflect the estimated net sale proceeds from the sale of impaired collateral dependent real estate loans. This change in methodology resulted in the allowance for loan losses as of March 31, 2013 being $494,000 more than it would have been without this change in methodology.

During the three months ended June 30, 2013, the Company modified its loss migration analysis methodology used to determine the formula allowance factors. When the Company originally established its loss migration analysis methodology during the quarter ended March 31, 2012, it reviewed the loss experience of each rolling twelve month period over the previous three years in order to calculate an annualized loss rate by loan category and risk rating. The use of three years of loss experience data was originally used because that was the extent of the detailed loss data, by loan category and risk rating that was available at the time. This three year historical look-back period was used through the quarter ended March 31, 2013. Starting with the quarter ended June 30, 2013, the Company reviews all available detailed loss experience data, going back to, and including, the twelve month period ended June 30, 2009, and does not limit the look-back period to the most recent three years of historical loss data. Using this data, the

Company calculates loss factors for each quarter from the quarter ended June 30, 2009 to the most recent quarter. The Company then calculates a weighted average formula allowance factor for each loan category and risk rating with the most recent quarterly loss factor being weighted 125%, the quarter ended June 30, 2009 loss factor being weighted 75%, and the loss factors for all the quarters between the most recent quarter and the quarter ended June 30, 2009, being weighted on a linear scale from 75% to 125%. This change is intended to more accurately reflect the risk inherent in the loan portfolio by considering historical loss data for all years as the data for new periods becomes available. This change in methodology resulted in the allowance for loan losses as of June 30, 2013 being $1,314,000 more than it would have been without this change in methodology.

During the three months ended September 30, 2013, the Company modified its methodology used to determine the allowance for changing environmental factors. Previously, the Company compared the current value of each environmental factor to a fixed baseline value. The deviation of the current value from the baseline value was then multiplied by a conversion factor to determine the required allowance related to each environmental factor. As of September 30, 2013, the Company replaced the fixed baseline values with average baseline values derived from historical averages, and adjusted the conversion factors. This change is intended to more accurately reflect the risk inherent in the portfolio by recognizing that baseline, or normal, levels for environmental factors may change over time. This change in methodology resulted in the allowance for loan losses as of September 30, 2013 being $1,665,000 more than it would have been without this change in methodology.

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Loans purchased or acquired in a business combination are referred to as acquired loans. Acquired loans are valued as of acquisition date in accordance with Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Topic 805, *Business Combinations*. Loans acquired with evidence of credit deterioration since origination for which it is probable that all contractually required payments will not be collected are referred to as purchased credit impaired (PCI) loans. PCI loans are accounted for under FASB ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. Under FASB ASC Topic 805 and FASB ASC Topic 310-30, PCI loans are recorded at fair value at acquisition date, factoring in credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for loan losses is not carried over or recorded as of the acquisition date. Fair value is defined as the present value of the future estimated principal and interest payments of the loan, with the discount rate used in the present value calculation representing the estimated effective yield of the loan. Default rates, loss severity, and prepayment speed assumptions are periodically reassessed and our estimate of future payments is adjusted accordingly. The difference between contractual future payments and estimated future payments is referred to as the nonaccretable difference. The difference between estimated future payments and the present value of the estimated future payments is referred to as the accretable yield. The accretable yield represents the amount that is expected to be recorded as interest income over the remaining life of the loan. If after acquisition, the Company determines that the estimated future cash flows of a PCI loan are expected to be more than the originally estimated, an increase in the discount rate (effective yield) would be made such that the newly increased accretable yield would be recognized, on a level yield basis, over the remaining estimated life of the loan. If, after acquisition, the Company determines that the estimated future cash flows of a PCI loan are expected to be less than the previously estimated, the discount rate would first be reduced until the present value of the reduced cash flow estimate equals the previous present value however, the discount rate may not be lowered below its original level at acquisition. If the discount rate has been lowered to its original level and the present value has not been sufficiently lowered, an allowance for loan loss would be established through a provision for loan losses charged to expense to decrease the present value to the required level. If the estimated cash flows improve after an allowance has been established for a loan, the allowance may be partially or fully reversed depending on the improvement in the estimated cash flows. Only after the allowance has been fully reversed may the discount rate be increased. PCI loans are put on nonaccrual status when cash flows cannot be reasonably estimated. PCI loans on nonaccrual status are accounted for using the cost recovery method or cash basis method of income recognition. PCI loans are charged off when evidence suggests cash flows are not recoverable. Foreclosed assets from PCI loans are recorded in foreclosed assets at fair value with the fair value at time of foreclosure representing cash flow from the loan. ASC 310-30 allows PCI loans with similar risk characteristics and acquisition time frame to be pooled and have their cash flows aggregated as if they were one loan. The Company elected to use the pooled method of ASC 310-30 for PCI other loans in the acquisition of certain assets and liabilities of Granite and Citizens.

Acquired loans that are not PCI loans are referred to as purchased not credit impaired (PNCI) loans. PNCI loans are accounted for under FASB ASC Topic 310-20, *Receivables Nonrefundable Fees and Other Costs,* in which interest income is accrued on a level-yield basis for performing loans. For income recognition purposes, this method assumes that all contractual cash flows will be collected, and no allowance for loan losses is established at the time of acquistion. Post-acquisition date, an allowance for loan losses may need to be established for acquired loans through a provision charged to earnings for credit losses incurred subsequent to acquisition. Under ASC 310-20, the loss would be measured based on the probable shortfall in relation to the contractual note requirements, consistent with our allowance for loan loss policy for similar loans.

When referring to PNCI and PCI loans we use the terms nonaccretable difference , accretable yield , or purchase discount . Nonaccretable difference is the difference between undiscounted contractual cash flows due and undiscounted cash flows we expect to collect, or put another way, it is the undiscounted contractual cash flows we do not expect to collect. Accretable yield is the difference between undiscounted cash flows we expect to collect and the value at which we have recorded the loan on our financial statements. On the date of acquisition, all purchased loans are recorded on our consolidated financial statements at estimated fair value. Purchase discount is the difference between the estimated fair value of loans on the date of acquisition and the principal amount owed by the borrower, net of charge offs, on the date of acquisition. We may also refer to discounts to principal balance of loans owed, net of charge-offs . Discounts to principal balance of loans owed, net of charge-offs is the difference between principal balance of loans owed, net of charge-offs, and loans as recorded on our financial statements. Discounts to principal balance of loans owed, net of charge-offs arise from purchase discounts, and equal the purchase discount on the acquisition date.

Loans are also categorized as covered or noncovered . Covered loans refer to loans covered by a FDIC loss sharing agreement. Noncovered loans refer to loans not covered by a FDIC loss sharing agreement.

Originated loans and PNCI loans are reviewed on an individual basis for reclassification to nonaccrual status when any one of the following occurs: the loan becomes 90 days past due as to interest or principal, the full and timely collection of additional interest or principal becomes uncertain, the loan is classified as doubtful by internal credit review or bank regulatory agencies, a portion of the principal balance has been charged off, or the Company takes possession of the collateral. Loans that are placed on nonaccrual even though the borrowers continue to repay the loans as scheduled are classified as performing nonaccrual and are included in total nonperforming loans. The reclassification of loans as nonaccrual does not necessarily reflect Management s judgment as to whether they are collectible.

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Interest income on originated nonaccrual loans that would have been recognized during the years ended December 31, 2013, 2012 and 2011, if all such loans had been current in accordance with their original terms, totaled $1,524,000, $5,281,000 and $5,422,000, respectively. Interest income actually recognized on these originated loans during the years ended December 31, 2013, 2012 and 2011 was $273,000, $936,000 and $1,497,000,000, respectively. Interest income on PNCI nonaccrual loans that would have been recognized during the years ended December 31, 2013, 2012 and 2011, if all such loans had been current in accordance with their original terms, totaled $295,000, $284,000 and $4,000. Interest income actually recognized on these PNCI loans during the years ended December 31, 2013, 2012 and 2011 was $38,000, $136,000 and $5,000.

The Company s policy is to place originated loans and PNCI loans 90 days or more past due on nonaccrual status. In some instances when an originated loan is 90 days past due Management does not place it on nonaccrual status because the loan is well secured and in the process of collection. A loan is considered to be in the process of collection if, based on a probable specific event, it is expected that the loan will be repaid or brought current. Generally, this collection period would not exceed 30 days. Loans where the collateral has been repossessed are classified as foreclosed assets. Management considers both the adequacy of the collateral and the other resources of the borrower in determining the steps to be taken to collect nonaccrual loans. Alternatives that are considered are foreclosure, collecting on guarantees, restructuring the loan or collection lawsuits.

The following table sets forth the amount of the Bank s nonperforming assets as of the dates indicated. For purposes of the following table, PCI other loans that are 90 days past due and still accruing are not considered nonperforming loans. Performing nonaccrual loans are loans that may be current for both principal and interest payments, or are less than 90 days past due, but for which payment in full of both principal and interest is not expected, and are not well secured and in the process of collection:

			December 31,		
(dollars in thousands)	2013	2012	2011	2010	2009
Performing nonaccrual loans	$ 48,112	$ 49,045	$ 61,164	$ 36,518	$ 22,870
Nonperforming nonaccrual loans	5,104	23,471	23,647	39,224	26,301
Total nonaccrual loans	53,216	72,516	84,811	75,742	49,171
Originated and PNCI loans 90 days past due and still accruing			920	245	700
Total nonperforming loans	53,216	72,516	85,731	75,987	49,871
Noncovered foreclosed assets	5,588	5,957	13,268	5,000	3,726
Covered foreclosed assets	674	1,541	3,064	4,913	
Total nonperforming assets	$ 59,478	$ 80,014	$ 102,063	$ 85,900	$ 53,597
U.S. government, including its agenciesand its government-sponsored agencies,guaranteed portion of nonperforming loans	$ 101	$ 131	$ 3,061	$ 3,937	$ 4,975
Indemnified portion ofcovered foreclosed assets	$ 539	$ 1,233	$ 2,451	$ 3,930	
Nonperforming assets to total assets	2.30%	3.07%	3.99%	3.92%	2.24%
Nonperforming loans to total loans	3.18%	4.63%	5.53%	5.35%	2.99%
	72%	59%	54%	56%	79%

Allowance for loan losses to nonperforming loans					
Allowance for loan losses, unamortized loan fees,and discounts to loan principal balances owed	4.09%	5.30%	6.34%	3.74%	2.48%

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The following tables set forth the amount of the Bank s nonperforming assets as of the dates indicated. For purposes of the following tables, PCI other loans that are 90 days past due and still accruing are not considered nonperforming loans. Performing nonaccrual loans are loans that may be current for both principal and interest payments, or are less than 90 days past due, but for which payment in full of both principal and interest is not expected, and are not well secured and in the process of collection:

	December 31, 2013				
(dollars in thousands)	Originated	PNCI	PCI cash basis	PCI - other	Total
Performing nonaccrual loans	$ 40,294	$ 1,649	$ 6,169		$ 48,112
Nonperforming nonaccrual loans	4,837	217	50		5,104
Total nonaccrual loans	45,131	1,866	6,219		53,216
Originated and PNCI loans 90 days past due and still accruing					
Total nonperforming loans	45,131	1,866	6,219		53,216
Noncovered foreclosed assets	5,479			$ 109	5,588
Covered foreclosed assets				674	674
Total nonperforming assets	$ 50,610	$ 1,866	$ 6,219	$ 783	$ 59,478
U.S. government, including its agencies and its government-sponsored agencies, guaranteed portion of nonperforming loans	$ 101				$ 101
Indemnified portion of covered foreclosed assets				$ 539	$ 539
Nonperforming assets to total assets					2.30%
Nonperforming loans to total loans	3.04%	1.38%	100.0%		3.18%
Allowance for loan losses to nonperforming loans	69%	153%	6%	n/m	72%
Allowance for loan losses, unamortized loan fees, and discounts to loan principal balances owed	2.36%	7.62%	64.5%	22.93%	4.09%

	December 31, 2012				
(dollars in thousands)	Originated	PNCI	PCI cash basis	PCI - other	Total
Performing nonaccrual loans	$ 38,646	$ 1,428	$ 8,971		$ 49,045
Nonperforming nonaccrual loans	23,123	348			23,471
Total nonaccrual loans	61,769	1,776	8,971		72,516
Originated loans 90 days past due and still accruing					
Total nonperforming loans	61,769	1,776	8,971		72,516
Noncovered foreclosed assets	5,172			$ 785	5,957

Covered foreclosed assets				1,541	1,541
Total nonperforming assets	$ 66,941	$ 1,776	$ 8,971	$ 2,326	$ 80,014
U.S. government, including its agencies and its government-sponsored agencies, guaranteed portion of nonperforming loans	$ 131				$ 131
Indemnified portion of covered foreclosed assets				$ 1,233	$ 1,233
Nonperforming assets to total assets					3.07%
Nonperforming loans to total loans	4.42%	1.81%	100.00%		4.63%
Allowance for loan losses to nonperforming loans	58%	111%	12%	n/m	59%
Allowance for loan losses, unamortized loan fees, and discounts to loan principal balances owed	2.76%	13.78%	61.60%	24.63%	5.30%

n/m not meaningful

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The following table shows the activity in the balance of nonperforming assets for the year ended December 31, 2013:

(dollars in thousands):	Balance at December 31, 2013	New NPA	Advances/ Capitalized Costs	Pay-downs /Sales /Upgrades	Charge-offs/ Write-downs	Transfers to Foreclosed Assets	Category Changes	Balance at December 31, 2012
Real estate mortgage:								
Residential	$ 4,959	$ 1,562	$ 48	$ (972)	$ (46)	$ (527)		$ 4,894
Commercial	31,871	9,823	744	(12,272)	(1,990)	(6,316)	$ 2,155	39,727
Consumer								
Home equity lines	11,601	3,931	89	(4,023)	(2,651)	(1,971)	(274)	16,500
Home equity loans	719	126	7	(108)	(94)		274	514
Auto indirect	54	75	1	(127)	(69)			174
Other consumer	62	198		(40)	(188)			92
Commercial	1,299	1,971		(1,612)	(1,645)	(2,115)	(2,071)	6,771
Construction:								
Residential	2,473	238		(794)	(20)	(263)		3,312
Commercial	178	169		(253)	(141)	(45)	$ (84)	532
Total nonperforming loans	53,216	18,093	889	(20,201)	(6,844)	(11,237)		72,516
Noncovered foreclosed assets	5,588		480	(10,992)	(601)	10,744		5,957
Covered foreclosed assets	674			(1,279)	(81)	$ 493		1,541
Total nonperforming assets	$ 59,478	$ 18,093	$ 1,369	$ (32,472)	$ (7,526)			$ 80,014

The table above does not include deposit overdraft charge-offs.

The following tables and narratives describe the activity in the balance of nonperforming assets during each of the three-month periods ending March 31, June 30, September 30, and December 31, 2013. These tables and narratives are presented in chronological order:

Changes in nonperforming assets during the three months ended December 31, 2013

(In thousands):	Balance at December 31, 2013	New NPA	Advances/ Capitalized Costs	Pay-downs /Sales /Upgrades	Charge-offs/ Write-downs	Transfers to Foreclosed Assets	Category Changes	Balance at September 30, 2013
Real estate mortgage:								
Residential	$ 4,959	$ 515	$ 43	$ (161)		$ (57)		$ 4,619
Commercial	31,871	2,066	98	(6,568)	(326)	(2,527)	86	39,042

Consumer								
Home equity lines	11,601	916	1	(745)	(808)	(618)	(188)	13,043
Home equity loans	719	70		(40)	(38)		188	539
Auto indirect	54	10		(14)	(1)			59
Other consumer	62	26		(3)	(26)			65
Commercial	1,299	1,067		(403)	(456)		(86)	1,177
Construction:								
Residential	2,473			(115)				2,588
Commercial	178	49		(74)	(49)			252
Total nonperforming loans	53,216	4,719	142	(8,123)	(1,704)	(3,202)		61,384
Noncovered foreclosed assets	5,588		480	(988)	(62)	3,202		2,956
Covered foreclosed assets	674			(510)				1,184
Total nonperforming assets	$ 59,478	$ 4,719	$ 622	$ (9,621)	$ (1,766)			$ 65,524

Nonperforming assets decreased during the fourth quarter of 2013 by $6,046,000 (9.23%) to $59,478,000 at December 31, 2013 compared to $65,524,000 at September 30, 2013. The decrease in nonperforming assets during the fourth quarter of 2013 was primarily the result of new nonperforming loans of $4,719,000, advances on existing nonperforming loans and capitalized costs on foreclosed assets of $622,000, less pay-downs, sales or upgrades of nonperforming loans to performing status totaling $8,123,000, less dispositions of foreclosed assets totaling $1,498,000, less loan charge-offs of $1,704,000, and less write-downs of foreclosed assets of $62,000.

The $4,719,000 in new nonperforming loans during the fourth quarter of 2013 was comprised of increases of $515,000 on four residential real estate loans, $2,066,000 on six commercial real estate loans, $986,000 on 15 home equity lines and loans, $10,000 on two indirect auto loans, $26,000 on 15 consumer loans, $1,067,000 on nine C&I loans, and $49,000 on a single commercial construction loan.

The $2,066,000 in new nonperforming commercial real estate loans was primarily made up of two loans totaling $1,346,000 secured by commercial office buildings in northern California, and a single loan in the amount of $250,000 secured by a commercial retail building in northern California. Related charge-offs are discussed below.

The $1,067,000 in new nonperforming C&I loans was primarily made up of a single loan in the amount of $550,000 secured by the accounts receivable of a business located in central California. Related charge-offs are discussed below.

Loan charge-offs during the three months ended December 31, 2013

In the fourth quarter of 2013, the Company recorded $1,704,000 in loan charge-offs and $136,000 in deposit overdraft charge-offs less $426,000 in loan recoveries and $147,000 in deposit overdraft recoveries resulting in $1,267,000 of net charge-offs. Primary causes of the loan charges taken in the fourth quarter of 2013 were gross charge-offs of $326,000 on three commercial real estate loans, $846,000 on 17 home equity lines and loans, $1,000 on a single indirect auto loan, $26,000 on 16 other consumer loans, $456,000 on eight C&I loans, and $49,000 on a single commercial construction loan.

During the fourth quarter of 2013, there were no individual charges greater than $250,000. Generally losses are triggered by non-performance by the borrower and calculated based on any difference between the current loan amount and the current value of the underlying collateral less any estimated costs associated with the disposition of the collateral.

Differences between the amounts explained in this section and the total charge-offs listed for a particular category are generally made up of individual charges of less than $250,000 each. Generally losses are triggered by non-performance by the borrower and calculated based on any difference between the current loan amount and the current value of the underlying collateral less any estimated costs associated with the disposition of the collateral.

Changes in nonperforming assets during the three months ended September 30, 2013

(In thousands):	Balance at September 30, 2013	New NPA	Advances/ Capitalized Costs	Pay-downs /Sales	Charge-offs/ Write-downs	Transfers to Foreclosed Assets	Category Changes	Balance at June 30, 2013
Real estate mortgage:								
Residential	$ 4,619	$ 632		$ (341)	$ (4)	$ (29)		$ 4,361
Commercial	39,042	3,262	$ 13	(1,431)	(23)	(290)		37,511
Consumer								
Home equity lines	13,043	1,193	27	(1,624)	(331)	(393)	$ (52)	14,223
Home equity loans	539	30	1	(12)	(30)		52	498
Auto indirect	59	2		(42)	(9)			108
Other consumer	65	56		(8)	(41)			58
Commercial	1,177	134		(97)	(318)			1,458
Construction:								
Residential	2,588	142		(351)		(142)		2,939
Commercial	252			(10)	(31)	(17)		310
Total nonperforming loans	61,384	5,451	41	(3,916)	(787)	(871)		61,466
Noncovered foreclosed assets	2,956			(1,738)	(47)	729		4,012

Covered foreclosed assets	1,184					142	1,042
Total nonperforming assets	$ 65,524	$ 5,451	$ 41	$ (5,654)	$ (834)		$ 66,520

Nonperforming assets decreased during the third quarter of 2013 by $996,000 (1.5%) to $65,524,000 at September 30, 2013 compared to $66,520,000 at June 30, 2013. The decrease in nonperforming assets during the third quarter of 2013 was primarily the result of new nonperforming loans of $5,451,000, advances on existing nonperforming loans of $41,000, less pay-downs or upgrades of nonperforming loans to performing status totaling $3,916,000, less dispositions of foreclosed assets totaling $1,738,000, less loan charge-offs of $787,000, and less write-downs of foreclosed assets of $47,000.

The primary causes of the $5,451,000 in new nonperforming loans during the third quarter of 2013 were increases of $632,000 on two residential real estate loans, $3,262,000 on six commercial real estate loans, $1,223,000 on 16 home equity lines and loans, $2,000 on three indirect auto loans, $56,000 on 21 consumer loans, $134,000 on three C&I loans, and $142,000 on one residential construction loan.

The $3,262,000 in new nonperforming commercial real estate loans was primarily comprised of one loan totaling $2,832,000 secured by agricultural production land and buildings in central California.

Loan charge-offs during the three months ended September 30, 2013

In the third quarter of 2013, the Company recorded $787,000 in loan charge-offs and $198,000 in deposit overdraft charge-offs less $954,000 in loan recoveries and $164,000 in deposit overdraft recoveries resulting in $133,000 of net recoveries. Primary causes of the charges taken in the third quarter of 2013 were gross charge-offs of $4,000 on one residential real estate loan, $22,000 on one commercial real estate loans, $361,000 on 12 home equity lines and loans, $10,000 on five auto indirect loans, $41,000 on 20 other consumer loans, $318,000 on five C&I loans, and $31,000 on one commercial construction loan.

The $787,000 in charge-offs the Bank took in its loan portfolio was comprised of 45 individual charges of less than $250,000 each spread throughout the Company s footprint. Generally losses are triggered by non-performance by the borrower and calculated based on any difference between the current loan amount and the current value of the underlying collateral less any estimated costs associated with the disposition of the collateral.

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During the third quarter of 2013, there were no individual charges greater than $250,000. Generally losses are triggered by non-performance by the borrower and calculated based on any difference between the current loan amount and the current value of the underlying collateral less any estimated costs associated with the disposition of the collateral.

Changes in nonperforming assets during the three months ended June 30, 2013

(In thousands):	Balance at June 30, 2013	New NPA	Advances/ Capitalized Costs	Pay- downs /Sales	Charge-offs/ Write-downs	Transfers to Foreclosed Assets	Category Changes	Balance at March 31, 2013
Real estate mortgage:								
Residential	$ 4,361	$ 406		$ (373)	$ (35)	$ (207)		$ 4,570
Commercial	37,511	1,771	$ 633	(1,531)	(839)	(656)	$ 2,069	36,064
Consumer								
Home equity lines	14,223	1,083	34	(692)	(746)	(450)	26	14,968
Home equity loans	498		6	(45)			(26)	563
Auto indirect	108	15		(41)	(33)			167
Other consumer	58	32		(10)	(32)			68
Commercial	1,458	157		(716)	(81)		(2,069)	4,167
Construction:								
Residential	2,939	87		(187)		(87)		3,126
Commercial	310	73		(5)		(28)		270
Total nonperforming loans	61,466	3,624	673	(3,600)	(1,766)	(1,428)		63,963
Noncovered foreclosed assets	4,012			(1,450)	(465)	1,340		4,587
Covered foreclosed assets	1,042			(502)	(81)	88		1,537
Total nonperforming assets	$ 66,520	$ 3,624	$ 673	$ (5,552)	$ (2,312)			$ 70,087

Nonperforming assets decreased during the second quarter of 2013 by $3,567,000 (5.1%) to $66,520,000 at June 30, 2013 compared to $70,087,000 at March 31, 2013. The decrease in nonperforming assets during the second quarter of 2013 was primarily the result of new nonperforming loans of $3,624,000, advances on existing nonperforming loans and capitalized costs on foreclosed assets of $673,000, less pay-downs or upgrades of nonperforming loans to performing status totaling $3,600,000, less dispositions of foreclosed assets totaling $1,952,000, less loan charge-offs of $1,766,000, and less write-downs of foreclosed assets of $546,000.

The primary causes of the $3,624,000 in new nonperforming loans during the second quarter of 2013 were increases of $406,000 on three residential real estate loans, $1,771,000 on five commercial real estate loans, $1,083,000 on 20 home equity lines and loans, $15,000 on one indirect auto loan, $32,000 on 14 consumer loans, $157,000 on two C&I loans, $87,000 on one residential construction loan, and $73,000 on one commercial construction loan.

The $1,771,000 in new nonperforming commercial real estate loans was primarily comprised of one loan totaling $325,000 secured by a commercial office building in northern California, one loan totaling $331,000 secured by a restaurant in northern California, and a $671,000 loan secured by a agricultural production land and buildings in northern California.

Loan charge-offs during the three months ended June 30, 2013

In the second quarter of 2013, the Company recorded $1,766,000 in loan charge-offs and $180,000 in deposit overdraft charge-offs less $903,000 in loan recoveries and $162,000 in deposit overdraft recoveries resulting in $881,000 of net charge-offs. Primary causes of the charges taken in the second quarter of 2013 were gross charge-offs of $35,000 on two residential real estate loans, $839,000 on four commercial real estate loans, $746,000 on 19 home equity lines and loans, $33,000 on four auto indirect loans, $32,000 on 14 other consumer loans, and $81,000 on four C&I loans.

The $839,000 in charge-offs the Company took in its commercial real estate portfolio were primarily the result of a $425,000 charge on a loan secured by a commercial warehouse in central California and a $351,000 charge on a loan secured by a commercial office in northern California. The remaining $63,000 was spread over two loans spread throughout the Company s footprint.

Differences between the amounts explained in this section and the total charge-offs listed for a particular category are generally made up of individual charges of less than $250,000 each. Generally losses are triggered by non-performance by the borrower and calculated based on any difference between the current loan amount and the current value of the underlying collateral less any estimated costs associated with the disposition of the collateral.

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Changes in nonperforming assets during the three months ended March 31, 2013

(In thousands):	Balance at March 31, 2013	New NPA	Advances/ Capitalized Costs	Pay-downs / Sales	Charge-offs/ Write-downs	Transfers to Foreclosed Assets	Category Changes	Balance at December 31, 2012
Real estate mortgage:								
Residential	$ 4,570	$ 9	$ 5	($ 97)	($ 7)	($ 234)		$ 4,894
Commercial	36,064	2,724		(2,740)	(803)	(2,844)		39,727
Consumer								
Home equity lines	14,968	739	27	(962)	(766)	(510)	$ (60)	16,500
Home equity loans	563	26		(11)	(26)		60	514
Auto indirect	167	48	1	(31)	(25)			174
Other consumer	68	84		(19)	(89)			92
Commercial	4,167	613		(396)	(790)	(2,115)	84	6,771
Construction:								
Residential	3,126	9		(141)	(20)	(34)		3,312
Commercial	270	47		(164)	(61)		(84)	532
Total nonperforming loans	63,963	4,299	33	(4,561)	(2,587)	(5,737)		72,516
Noncovered foreclosed assets	4,587			(6,816)	(27)	5,473		5,957
Covered foreclosed assets	1,537			(268)		264		1,541
Total nonperforming assets	$ 70,087	$ 4,299	$ 33	($ 11,645)	($ 2,614)			$ 80,014

Nonperforming assets decreased during the first quarter of 2013 by $9,927,000 (12.4%) to $70,087,000 at March 31, 2013 compared to $80,014,000 at December 31, 2012. The decrease in nonperforming assets during the first quarter of 2013 was primarily the result of new nonperforming loans of $4,299,000, advances on existing nonperforming loans and capitalized costs on foreclosed assets of $33,000, less pay-downs or upgrades of nonperforming loans to performing status totaling $4,561,000, less dispositions of foreclosed assets totaling $7,084,000, less loan charge-offs of $2,587,000, and less write-downs of foreclosed assets of $27,000.

The primary causes of the $4,299,000 in new nonperforming loans during the first quarter of 2013 were increases of $9,000 on one residential real estate loan, $2,724,000 on six commercial real estate loans, $766,000 on 20 home equity lines and loans, $48,000 on eight indirect auto loans, $84,000 on 21 consumer loans, $613,000 on 14 C&I loans, $9,000 on one residential construction loan, and $47,000 on one commercial construction loan.

The $2,724,000 in new nonperforming commercial real estate loans was primarily comprised of one loan totaling $2,133,000 secured by a commercial retail building in northern California, and a $354,000 loan secured by a commercial office building in northern California.

Loan charge-offs during the three months ended March 31, 2013

In the first quarter of 2013, the Company recorded $2,587,000 in loan charge-offs and $184,000 in deposit overdraft charge-offs less $900,000 in loan recoveries and $198,000 in deposit overdraft recoveries resulting in $1,673,000 of net charge-offs. Primary causes of the charges taken in the first quarter of 2013 were gross charge-offs of $7,000 on one residential real estate loan, $803,000 on five commercial real estate loans, $792,000 on 22 home equity lines and loans, $25,000 on eight auto indirect loans, $89,000 on 24 other consumer loans, $613,000 on 15 C&I loans, $20,000 on two residential construction loans, and $61,000 on two commercial construction loans.

The $803,000 in charge-offs the Company took in its commercial real estate portfolio was primarily the result of a $734,000 charge on a loan secured by a commercial warehouse in central California. The remaining $69,000 was spread over four loans spread throughout the Company s footprint.

Differences between the amounts explained in this section and the total charge-offs listed for a particular category are generally made up of individual charges of less than $250,000 each. Generally losses are triggered by non-performance by the borrower and calculated based on any difference between the current loan amount and the current value of the underlying collateral less any estimated costs associated with the disposition of the collateral.

Allowance for Loan Losses

The Company s allowance for loan losses is comprised of allowances for originated, PNCI and PCI loans. All such allowances are established through a provision for loan losses charged to expense.

Originated and PNCI loans, and deposit related overdrafts are charged against the allowance for originated loan losses when Management believes that the collectability of the principal is unlikely or, with respect to consumer installment loans, according to an established delinquency schedule. The allowances for originated and PNCI loan losses are amounts that Management believes will be adequate to absorb probable losses inherent in existing originated loans, based on evaluations of the collectability, impairment and prior loss experience of those loans and leases. The evaluations take into consideration such factors as changes in the nature and size of the portfolio, overall portfolio quality, loan concentrations, specific problem loans, and current economic conditions that may affect the borrower s ability to pay. The Company defines an originated or PNCI loan as impaired when it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired originated and PNCI loans are measured based on the present value of expected future cash flows discounted at the loan s original effective interest rate. As a practical expedient, impairment may be measured based on the loan s observable market price or the fair value of the collateral if the loan is collateral dependent. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through a valuation allowance.

In situations related to originated and PNCI loans where, for economic or legal reasons related to a borrower s financial difficulties, the Company grants a concession for other than an insignificant period of time to the borrower that the Company would not otherwise consider, the related loan is classified as a troubled debt restructuring (TDR). The Company strives to identify borrowers in financial difficulty early and work with them to modify to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where the Company grants the borrower new terms that provide for a reduction of either interest or principal, the Company measures any impairment on the restructuring as noted above for impaired loans. TDR loans are classified as impaired until they are fully paid off or charged off. Loans that are in nonaccrual status at the time they become TDR loans, remain in nonaccrual status until the borrower demonstrates a sustained period of performance which the Company generally believes to be six consecutive months of payments, or equivalent. Otherwise, TDR loans are subject to the same nonaccrual and charge-off policies as noted above with respect to their restructured principal balance.

Credit risk is inherent in the business of lending. As a result, the Company maintains an allowance for loan losses to absorb losses inherent in the Company s originated and PNCI loan portfolios. These are maintained through periodic charges to earnings. These charges are included in the Consolidated Income Statements as provision for loan losses. All specifically identifiable and quantifiable losses are immediately charged off against the allowance. However, for a variety of reasons, not all losses are immediately known to the Company and, of those that are known, the full extent of the loss may not be quantifiable at that point in time. The balance of the Company s allowances for originated and PNCI loan losses are meant to be an estimate of these unknown but probable losses inherent in these portfolios.

The Company formally assesses the adequacy of the allowance for originated and PNCI loan losses on a quarterly basis. Determination of the adequacy is based on ongoing assessments of the probable risk in the outstanding originated and PNCI loan portfolios, and to a lesser extent the Company s originated and PNCI loan commitments. These assessments include the periodic re-grading of credits based on changes in their individual credit characteristics including delinquency, seasoning, recent financial performance of the borrower, economic factors, changes in the interest rate environment, growth of the portfolio as a whole or by segment, and other factors as warranted. Loans are initially graded when originated or acquired. They are re-graded as they are renewed, when there is a new loan to the same borrower, when identified facts demonstrate heightened risk of nonpayment, or if they become delinquent. Re-grading of larger problem loans occurs at least quarterly. Confirmation of the quality of the grading process is obtained by independent credit reviews conducted by consultants specifically hired for this purpose and by various bank regulatory agencies.

The Company s method for assessing the appropriateness of the allowance for originated and PNCI loan losses includes specific allowances for impaired loans and leases, formula allowance factors for pools of credits, and allowances for changing environmental factors (e.g., interest rates, growth, economic conditions, etc.). Allowance factors for loan pools are based on historical loss experience by product type and prior risk rating. Allowances for impaired loans are based on analysis of individual credits. Allowances for changing environmental factors are Management s best estimate of the probable impact these changes have had on the originated or PNCI loan portfolio as a whole. The allowances for originated and PNCI loans are included in the allowance for loan losses.

As noted above, the allowances for originated and PNCI loan losses consists of a specific allowance, a formula allowance, and an allowance for environmental factors. The first component, the specific allowance, results from the analysis of identified credits that meet management s criteria for specific evaluation. These loans are reviewed individually to determine if such loans are considered impaired. Impaired loans are those where management has concluded that it is probable that the borrower will be unable to pay all amounts due under the contractual terms. Impaired loans are specifically reviewed and evaluated individually by management for loss potential by evaluating sources of repayment, including collateral as applicable, and a specified allowance for loan losses is established where necessary.

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During the three months ended March 31, 2013, the Company changed the method it uses to estimate net sale proceeds from real estate collateral sales when calculating the allowance for loan losses associated with impaired real estate collateral dependent loans. Previously, the Company used the greater of fifteen percent or actual estimated selling costs. Currently, the Company uses the actual estimated selling costs, and an adjustment to appraised value based on the age of the appraisal. These changes are intended to more accurately reflect the estimated net sale proceeds from the sale of impaired collateral dependent real estate loans. This change in methodology resulted in the allowance for loan losses as of March 31, 2013 being $494,000 more than it would have been without this change in methodology.

The second component of the allowance for originated and PNCI loan losses, the formula allowance, is an estimate of the probable losses that have occurred across the major loan categories in the Company s originated and PNCI loan portfolios. This analysis is based on loan grades by pool and the loss history of these pools. This analysis covers the Company s entire originated and PNCI loan portfolios including unused commitments but excludes any loans that were analyzed individually and assigned a specific allowance as discussed above. The total amount allocated for this component is determined by applying loss estimation factors to outstanding loans and loan commitments. The loss factors were previously based primarily on the Company s historical loss experience tracked over a five-year period and adjusted as appropriate for the input of current trends and events. Because historical loss experience varies for the different categories of originated loans, the loss factors applied to each category also differed. In addition, there is a greater chance that the Company would suffer a loss from a loan that was risk rated less than satisfactory than if the loan was last graded satisfactory. Therefore, for any given category, a larger loss estimation factor was applied to less than satisfactory loans than to those that the Company last graded as satisfactory. The resulting formula allowance was the sum of the allocations determined in this manner.

During the three month period ended March 31, 2012, the Company converted to a loss migration analysis to determine the formula allowance. Under this method, the Company reviewed the loss experience of each quarter over the previous three years and determined an annualized loss rate by loan category as well as risk rating at the beginning of each period reviewed. A weighted average was then applied to arrive at the average annualized loss rate for each loan category and risk rating, which was then applied against the net recorded investment for all loans by category and risk rating not classified as impaired. The effect of this change in methodology resulted in a net reduction in formula allowance required of $3,296,000. This loss migration approach was promoted by regulatory agencies and implemented by the Company during the three month period ended March 31, 2012 as this was the first period in which sufficient historical data could be compiled to support the analysis.

During the three months ended June 30, 2013, the Company modified its loss migration analysis methodology used to determine the formula allowance factors. When the Company originally established its loss migration analysis methodology during the quarter ended March 31, 2012, it reviewed the loss experience of each quarter over the previous three years in order to calculate an annualized loss rate by loan category and risk rating. The use of three years of loss experience data was originally used because that was the extent of the detailed loss data, by loan category and risk rating that was available at the time. This three year historical look-back period was used through the quarter ended March 31, 2013. Starting with the quarter ended June 30, 2013, the Company reviews all available detailed loss experience data, going back to, and including, the quarter end June 30, 2008, and does not limit the look-back period to the most recent three years of historical loss data. Using this data, the Company calculates loss factors for each quarter from the quarter ended June 30, 2009 to the most recent quarter. The Company then calculates a weighted average formula allowance factor for each loan category and risk rating with the most recent quarterly loss factor being weighted 125%, the quarter ended June 30, 2009 loss factor being weighted 75%, and the loss factors for all the quarters between the most recent quarter and the quarter ended June 30, 2009, being weighted on a linear scale from 75% to 125%. This change is intended to more accurately reflect the risk inherent in the loan portfolio by considering historical loss data for all years as the data for new periods becomes available. This change in methodology resulted in the allowance for loan losses as of June 30, 2013 being $1,314,000 more than it would have been without this change in methodology.

In addition to updating the method by which the estimated formula allowance required is calculated, management also improved the monitoring and risk recognition within its consumer portfolio. Previously, consumer loans with no identified credit weakness had a risk rating of Pass assigned, and this would generally only change if the loan went 90 days past due, at which time the risk rating was systematically downgraded to Substandard and the loan was placed in nonaccrual. For the period ended March 31, 2012, management has chosen to monitor consumer loans based on current credit score and assign a risk rating of Special Mention for those scores below a certain threshold. This change is primarily intended to more effectively monitor and manage the risk in the Company s portfolio of consumer loans and lines of credit secured by junior liens on 1-4 family residential properties. We believe that the current credit score allows us to better account for increasing default risk in these types of loans. It is also the only reasonably available tool that can be used to attempt to monitor the performance of the senior lien on the associated properties, as the Company does not generally service both the 1st and 2nd loans in these instances. The result of this change in methodology resulted in an additional required formula allowance of $1,874,000. $1,596,000 of this additional requirement is specifically related to loans and lines of credit secured by junior liens on 1-4 family residential properties.

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The third component of the allowances for originated and PNCI loan losses, the environmental factor allowance, is a component that is not allocated to specific loans or groups of loans, but rather is intended to absorb losses that may not be provided for by the other components.

There are several primary reasons that the other components discussed above might not be sufficient to absorb the losses present in the originated and PNCI loan portfolios, and the environmental factor allowance is used to provide for the losses that have occurred because of them.

The first reason is that there are limitations to any credit risk grading process. The volume of originated and PNCI loans makes it impractical to re-grade every loan every quarter. Therefore, it is possible that some currently performing originated or PNCI loans not recently graded will not be as strong as their last grading and an insufficient portion of the allowance will have been allocated to them. Grading and loan review often must be done without knowing whether all relevant facts are at hand. Troubled borrowers may deliberately or inadvertently omit important information from reports or conversations with lending officers regarding their financial condition and the diminished strength of repayment sources.

The second reason is that the loss estimation factors are based primarily on historical loss totals. As such, the factors may not give sufficient weight to such considerations as the current general economic and business conditions that affect the Company s borrowers and specific industry conditions that affect borrowers in that industry. The factors might also not give sufficient weight to other environmental factors such as changing economic conditions and interest rates, portfolio growth, entrance into new markets or products, and other characteristics as may be determined by Management.

Specifically, in assessing how much environmental factor allowance needed to be provided, management considered the following:

- with respect to the economy, management considered the effects of changes in GDP, unemployment, CPI, debt statistics, housing starts, housing sales, auto sales, agricultural prices, and other economic factors which serve as indicators of economic health and trends and which may have an impact on the performance of our borrowers, and

- with respect to changes in the interest rate environment, management considered the recent changes in interest rates and the resultant economic impact it may have had on borrowers with high leverage and/or low profitability; and

- with respect to changes in energy prices, management considered the effect that increases, decreases or volatility may have on the performance of our borrowers, and

- with respect to loans to borrowers in new markets and growth in general, management considered the relatively short seasoning of such loans and the lack of experience with such borrowers, and with respect to the potential imprecision in the total Allowance for Loan Losses calculation, management previously included an unspecified reserve equal to 1.00% of the total allowance and reserve for unfunded commitments calculated. For the period ended March 31, 2012, this unspecified reserve was eliminated resulting in a reduction in allowances required of $425,000, and

with respect to loans that have not yet been identified as impaired, management considered the volume and severity of past due loans. This environmental consideration was added to the Company s Allowance for Loan Losses methodology for the period ended March 31, 2012 and resulted in additional allowances required of $459,000.

Each of these considerations was assigned a factor and applied to a portion or the entire originated and PNCI loan portfolios. Since these factors are not derived from experience and are applied to large non-homogeneous groups of loans, they are available for use across the portfolio as a whole.

During the three months ended September 30, 2013, the Company modified its methodology used to determine the allowance for changing environmental factors. Previously, the Company compared the current value of each environmental factor to a fixed baseline value. The deviation of the current value from the baseline value was then multiplied by a conversion factor to determine the required allowance related to each environmental factor. As of September 30, 2013, the Company replaced the fixed baseline values with average baseline values derived from historical averages, and adjusted the conversion factors. This change is intended to more accurately reflect the risk inherent in the portfolio by recognizing that baseline, or normal, levels for environmental factors may change over time. This change in methodology resulted in the allowance for loan losses as of September 30, 2013 being $1,665,000 more than it would have been without this change in methodology.

Acquired loans are valued as of acquisition date in accordance with Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Topic 805, *Business Combinations*. Loans purchased with evidence of credit deterioration since origination for which it is probable that all contractually required payments will not be collected are referred to as purchased credit impaired (PCI) loans. PCI loans are accounted for under FASB ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. In addition, because of the significant credit discounts associated with the loans acquired in the Granite acquisition, the Company elected to account for all loans acquired in the Granite acquisition under FASB ASC Topic 310-30, and classify them all as PCI loans. Under FASB ASC Topic 805 and FASB ASC Topic 310-30, PCI loans are recorded at fair value at acquisition date, factoring in credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for loan losses is not carried over or recorded as of the acquisition date. Fair value is defined as the present value of the future estimated principal and interest payments of the loan, with the discount rate used in the present value calculation representing the estimated effective yield of the loan. The difference between contractual future payments and estimated future payments is referred to as the nonaccretable difference. The difference between estimated future payments and the present value of the estimated future payments is referred to as the accretable yield. The accretable yield represents the amount that is expected to be recorded as interest income over the remaining life of the loan. If after acquisition, the Company determines that the future cash flows of a PCI loan are expected to be more than the originally estimated, an increase in the discount rate (effective yield) would be made such that the newly increased accretable yield would be recognized, on a level yield basis, over the remaining estimated life of the loan. If after acquisition, the Company determines that the future cash flows of a PCI loan are expected to be less than the previously estimated, the discount rate would first be reduced until the present value of the reduced cash flow estimate equals the previous present value however, the discount rate may not be lowered below its original level. If the discount rate has been lowered to its original level and the present value has not been sufficiently lowered, an allowance for loan loss would be established through a provision for loan losses charged to expense to decrease the present value to the required level. If the estimated cash flows improve after an allowance has been established for a loan, the allowance may be partially or fully reversed depending on the improvement in the estimated cash flows. Only after the allowance has been fully reversed may the discount rate be increased. PCI loans are put on nonaccrual status when cash flows cannot be reasonably estimated. PCI loans are charged off when evidence suggests cash flows are not recoverable. Foreclosed assets from PCI loans are recorded in foreclosed assets at fair value with the fair value at time of foreclosure representing cash flow from the loan. ASC 310-30 allows PCI loans with similar risk characteristics and acquisition time frame to be pooled and have their cash flows aggregated as if they were one loan.

The Components of the Allowance for Loan Losses

The following table sets forth the Bank s allowance for loan losses as of the dates indicated (dollars in thousands):

	December 31,				
	2013	2012	2011	2010	2009
Allowance for originated and PNCI loan losses:					
Specific allowance	$ 3,975	$ 4,505	$ 5,993	$ 6,945	$ 8,627
Formula allowance	24,611	29,314	32,023	31,070	23,361
Environmental factors allowance	5,619	3,919	3,687	2,948	3,485
Allowance for originated and PNCI loan losses	34,205	37,738	41,703	40,963	35,473
Allowance for PCI loan losses	4,040	4,910	4,211	1,608	
Allowance for loan losses	$ 38,245	$ 42,648	$ 45,914	$ 42,571	$ 35,473
Allowance for loan losses to loans	2.29%	2.73%	2.96%	3.00%	2.37%

Based on the current conditions of the loan portfolio, management believes that the $38,245,000 allowance for loan losses at December 31, 2013 is adequate to absorb probable losses inherent in the Bank s loan portfolio. No assurance can be given, however, that adverse economic conditions or other circumstances will not result in increased losses in the portfolio.

The following table summarizes the allocation of the allowance for loan losses between loan types:

	December 31,				
(dollars in thousands)	2013	2012	2011	2010	2009
Real estate mortgage	$ 12,854	$ 12,305	$ 15,621	$ 15,707	$ 7,689
Consumer	18,238	23,461	20,506	17,779	17,026
Commercial	4,331	4,703	6,545	5,991	6,958
Real estate construction	2,822	2,179	3,242	3,094	3,800
Total allowance for loan losses	$ 38,245	$ 42,648	$ 45,914	$ 42,571	$ 35,473

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The following table summarizes the allocation of the allowance for loan losses between loan types as a percentage of the total allowance for loan losses:

	December 31,				
	2013	2012	2011	2010	2009
Real estate mortgage	33.6%	28.9%	34.0%	36.9%	21.7%
Consumer	47.7%	55.0%	44.7%	41.8%	48.0%
Commercial	11.3%	11.0%	14.2%	14.1%	19.6%
Real estate construction	7.4%	5.1%	7.1%	7.2%	10.7%
Total allowance for loan losses	100.0%	100.0%	100.0%	100.0%	100.0%

The following table summarizes the allocation of the allowance for loan losses between loan types as a percentage of the total loans:

	December 31,				
	2013	2012	2011	2010	2009
Real estate mortgage	1.16%	1.22%	1.62%	1.88%	0.91%
Consumer	4.76%	6.08%	5.05%	4.49%	3.97%
Commercial	3.28%	3.47%	4.70%	4.18%	4.24%
Real estate construction	5.75%	6.59%	8.18%	6.89%	6.47%
Total allowance for loan losses	2.29%	2.73%	2.96%	3.00%	2.37%

The following tables summarize the activity in the allowance for loan losses, reserve for unfunded commitments, and allowance for losses (which is comprised of the allowance for loan losses and the reserve for unfunded commitments) for the years indicated (dollars in thousands):

	Year ended December 31,				
	2013	2012	2011	2010	2009
Allowance for loan losses:					
Balance at beginning of period	$ 42,648	$ 45,914	$ 42,571	$ 35,473	$ 27,590
(Benefit from) provision for loan losses	(715)	9,423	23,060	37,458	31,450
Loans charged off:					
Real estate mortgage:					
Residential	(46)	(1,558)	(1,655)	(1,498)	(583)
Commercial	(2,038)	(3,457)	(4,451)	(8,281)	(1,223)
Consumer:					
Home equity lines	(2,651)	(8,042)	(9,746)	(11,221)	(7,487)
Home equity loans	(94)	(385)	(789)	(1,339)	(656)
Auto indirect	(68)	(83)	(427)	(1,403)	(2,806)
Other consumer	(887)	(1,202)	(1,158)	(1,687)	(1,238)

Commercial	(1,599)	(1,251)	(2,534)	(3,539)	(3,219)
Construction:					
Residential	(20)	(406)	(634)	(4,666)	(7,737)
Commercial	(140)	(100)	(653)	(94)	(89)
Total loans charged off	(7,543)	(16,484)	(22,047)	(33,728)	(25,038)
Recoveries of previously charged-off loans:					
Real estate mortgage:					
Residential	345	147	126	2	40
Commercial	994	1,020	127	1,456	71
Consumer:					
Home equity lines	1,053	398	573	138	98
Home equity loans	41	100	45	15	
Auto indirect	195	215	379	505	484
Other consumer	759	860	839	816	677
Commercial	340	643	173	205	71
Construction:					
Residential	63	412	28	231	30
Commercial	65		40		
Total recoveries of previously charged off loans	3,855	3,795	2,330	3,368	1,471
Net charge-offs	(3,688)	(12,689)	(19,717)	(30,360)	(23,567)
Balance at end of period	$ 38,245	$ 42,648	$ 45,914	$ 42,571	$ 35,473

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	Year ended December 31, 2013	2012	2011	2010	2009
Reserve for unfunded commitments:					
Balance at beginning of period	$ 3,615	$ 2,740	$ 2,640	$ 3,640	$ 2,565
Provision for losses unfunded commitments	(1,200)	875	100	(1,000)	1,075
Balance at end of period	$ 2,415	$ 3,615	$ 2,740	$ 2,640	$ 3,640
Balance at end of period:					
Allowance for loan losses	$ 38,245	$ 42,648	$ 45,914	$ 42,571	$ 35,473
Reserve for unfunded commitments	2,415	3,615	2,740	2,640	3,640
Allowance for loan losses and reserve for unfunded commitments	$ 40,660	$ 46,263	$ 48,654	$ 45,211	$ 39,113
As a percentage of total loans at end of period:					
Allowance for loan losses	2.29%	2.73%	2.96%	3.00%	2.37%
Reserve for unfunded commitments	0.14%	0.23%	0.18%	0.18%	0.24%
Allowance for loan losses and reserve for unfunded commitments	2.43%	2.96%	3.14%	3.18%	2.61%
Average total loans	$ 1,610,725	$ 1,552,540	$ 1,442,821	$ 1,464,606	$ 1,542,147
Ratios:					
Net charge-offs during period to average loans outstanding during period	0.23%	0.82%	1.37%	2.07%	1.53%
Provision for loan losses to average loans outstanding	(0.04)%	0.61%	1.60%	2.56%	2.04%
Allowance for loan losses to loans at year end	2.29%	2.73%	2.96%	3.00%	2.37%

Foreclosed Assets, Net of Allowance for Losses

The following tables detail the components and summarize the activity in foreclosed assets, net of allowances for losses for the years indicated (dollars in thousands):

(dollars in thousands):	Balance at December 31,	New NPA	Advances/ Capitalized	Sales	Valuation Adjustments	Transfers from Loans	Category Changes	Balance at December 31, 2012

	2013		Costs					
Noncovered:								
Land & Construction	$ 578			$ (1,107)	$ (70)	$ 79		$ 1,676
Residential real estate	1,944		$ 480	(2,853)	(101)	2,676		1,742
Commercial real estate	3,066			(7,032)	(430)	7,989		2,539
Total noncovered	5,588		480	(10,992)	(601)	10,744		5,957
Covered:								
Land & Construction	674			(267)		229		712
Residential real estate								
Commercial real estate				(1,012)	(81)	264		829
Total covered	674			(1,279)	(81)	493		1,541
Total foreclosed assets	$ 6,262		$ 480	$ (12,271)	$ (682)	$ 11,237		$ 7,498

(dollars in thousands):	Balance at December 31, 2012	New NPA	Advances/ Capitalized Costs	Sales	Valuation Adjustments	Transfers from Loans	Category Changes	Balance at December 31, 2011
Noncovered:								
Land & Construction	$ 1,676			$ (3,549)	$ (587)	$ 778		$ 5,034
Residential real estate	1,742		$ 833	(5,452)	(336)	3,507		3,190
Commercial real estate	2,539		(75)	(5,775)	(344)	3,689		5,044
Total noncovered	5,957		758	(14,776)	(1,267)	7,974		13,268
Covered:								
Land & Construction	712			(779)	(308)			1,799
Residential real estate				(121)	(59)			180
Commercial real estate	829		225	(795)	(94)	408		1,085
Total covered	1,541		225	(1,695)	(461)	408		3,064
Total foreclosed assets	$ 7,498		$ 983	$ (16,471)	$ (1,728)	$ 8,382		$ 16,332

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Premises and Equipment

Premises and equipment were comprised of:

	December 31, 2013	December 31, 2012
	(In thousands)	
Land & land improvements	$ 5,975	$ 5,929
Buildings	30,103	23,090
Furniture and equipment	27,881	25,877
	63,959	54,896
Less: Accumulated depreciation	(32,397)	(32,101)
	31,562	22,795
Construction in progress	50	4,190
Total premises and equipment	$ 31,612	$ 26,985

During the year ended December 31, 2013, premises and equipment increased $4,627,000 due to purchases of $8,313,000, that were partially offset by depreciation of $3,635,000 and disposals of premises and equipment with net book value of $51,000. Included in the $8,313,000 of purchases during the year ended December 31, 2013 is $5,576,000 related to the Company s new campus and operations center in Chico, California that was completed and put into service during June 2013. As of December 31, 2013 the campus and operations center had a cost basis as follows: land & land improvements $450,000, building $8,405,000, and furniture and equipment $2,362,000.

Intangible Assets

Intangible assets at December 31, 2013 and 2012 were comprised of the following:

	December 31, 2013	December 31, 2012
(In thousands)		
Core-deposit intangible	$ 883	$ 1,092
Goodwill	15,519	15,519
Total intangible assets	$ 16,402	$ 16,611

The core-deposit intangible assets resulted from the Bank s acquisition of Citizens in 2011, and Granite in 2010. The goodwill intangible asset resulted from the North State National Bank acquisition in 2003. Amortization of core deposit intangible assets amounting to $209,000, $209,000, and $177,000 was recorded in 2013, 2012, and 2011, respectively.

Deposits

Deposits at December 31, 2013 increased $120,781,000 (5.3%) over the 2012 year-end balances to $2,410,483,000. All categories of deposits were up in 2013 except time certificates. Included in the December 31, 2013 certificate of deposit balances is $5,000,000 from the State of California. The Bank participates in a deposit program offered by the State of California whereby the State may make deposits at the Bank s request subject to collateral and creditworthiness constraints. The negotiated rates on these State deposits are generally more favorable than other wholesale funding sources available to the Bank.

Deposits at December 31, 2012 increased $99,166,000 (4.5%) over the 2011 year-end balances to $2,289,702,000. All categories of deposits were up in 2012 with the exception of money market accounts and time certificates. Included in the December 31, 2012 certificate of deposit balances is $5,000,000 from the State of California.

Long-Term Debt

See Note 16 to the consolidated financial statements at Item 8 of this report for information about the Company s other borrowings, including long-term debt.

Junior Subordinated Debt

See Note 17 to the consolidated financial statements at Item 8 of this report for information about the Company s junior subordinated debt.

Equity

See Note 19 and Note 29 in the consolidated financial statements at Item 8 of this report for a discussion of shareholders equity and regulatory capital, respectively. Management believes that the Company s capital is adequate to support anticipated growth, meet the cash dividend requirements of the Company and meet the future risk-based capital requirements of the Bank and the Company.

Market Risk Management

Overview. The goal for managing the assets and liabilities of the Bank is to maximize shareholder value and earnings while maintaining a high quality balance sheet without exposing the Bank to undue interest rate risk. The Board of Directors has overall responsibility for the Company s interest rate risk management policies. The Bank has an Asset and Liability Management Committee (ALCO) which establishes and monitors guidelines to control the sensitivity of earnings to changes in interest rates.

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

Simulation of net interest margin and market value of equity under various interest rate scenarios is the primary tool used to measure interest rate risk. Using computer-modeling techniques, the Bank is able to estimate the potential impact of changing interest rates on net interest margin and market value of equity. A balance sheet forecast is prepared using inputs of actual loan, securities and interest-bearing liability (i.e. deposits/borrowings) positions as the beginning base.

In the simulation of net interest income, the forecast balance sheet is processed against various interest rate scenarios. These various interest rate scenarios include a flat rate scenario, which assumes interest rates are unchanged in the future, and rate ramp scenarios including -100, +100, and +200 basis points around the flat scenario. These ramp scenarios assume that interest rates increase or decrease evenly (in a ramp fashion) over a twelve-month period and remain at the new levels beyond twelve months.

The following table summarizes the projected effect on net interest income and net income due to changing interest rates as measured against a flat rate (no interest rate change) scenario over the succeeding twelve month period. The simulation results shown below assume no changes in the structure of the Company s balance sheet over the twelve months being measured (a flat balance sheet scenario), and that deposit rates will track general interest rate changes by approximately 50%:

Interest Rate Risk Simulation of Net Interest Income and Net Income as of December 31, 2013

Change in Interest Rates (Basis Points)	Estimated Change in Net Interest Income (NII) (as % of flat NII)
+200(ramp)	0.72%
+100(ramp)	0.20%
+0(flat)	
-100(ramp)	(0.81%)

In the simulation of market value of equity, the forecast balance sheet is processed against various interest rate scenarios. These various interest rate scenarios include a flat rate scenario, which assumes interest rates are unchanged in the future, and rate shock scenarios including -100, +100, and +200 basis points around the flat scenario. These rate shock scenarios assume that interest rates increase or decrease immediately (in a shock fashion) and remain at the new level in the future.

The following table summarizes the effect on market value of equity due to changing interest rates as measured against a flat rate (no change) scenario:

Interest Rate Risk Simulation of Market Value of Equity as of December 31, 2013

Change in Interest Rates (Basis Points)	Estimated Change in Market Value of Equity (MVE) (as % of flat MVE)
+200(shock)	0.27%
+100(shock)	0.70%
+ 0(flat)	
-100(shock)	(9.18%)

These results indicate that given a flat balance sheet scenario, and if deposit rates track general interest rate changes by approximately 50%, the Company s balance sheet is neutral to slightly asset sensitive over a twelve month time horizon. Neutral sensitivity implies that net interest income does not change when interest rates change. Asset sensitive implies that net interest income increases when interest rates rise, and decrease when interest rates decrease. The asset liability management policy limits aggregate market risk, as measured in this fashion, to an acceptable level within the context of risk-return trade-offs.

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The simulation results noted above do not incorporate any management actions that might moderate the negative consequences of interest rate deviations. In addition, the simulation results noted above contain various assumptions such as a flat balance sheet, and the rate that deposit interest rates change as general interest rates change. Therefore, they do not reflect likely actual results, but serve as estimates of interest rate risk.

As with any method of measuring interest rate risk, certain shortcomings are inherent in the method of analysis presented in the preceding tables. For example, although certain of the Company s assets and liabilities may have similar maturities or repricing time frames, they may react in different degrees to changes in market interest rates. In addition, the interest rates on certain of the Company s asset and liability categories may precede, or lag behind, changes in market interest rates. Also, the actual rates of prepayments on loans and investments could vary significantly from the assumptions utilized in deriving the results as presented in the preceding tables. Further, a change in U.S. Treasury rates accompanied by a change in the shape of the treasury yield curve could result in different estimations from those presented herein. Accordingly, the results in the preceding tables should not be relied upon as indicative of actual results in the event of changing market interest rates. Additionally, the resulting estimates of changes in market value of equity are not intended to represent, and should not be construed to represent, estimates of changes in the underlying value of the Company.

Interest rate sensitivity is a function of the repricing characteristics of the Company s portfolio of assets and liabilities. One aspect of these repricing characteristics is the time frame within which the interest-bearing assets and liabilities are subject to change in interest rates either at replacement, repricing or maturity. An analysis of the repricing time frames of interest-bearing assets and liabilities is sometimes called a gap analysis because it shows the gap between assets and liabilities repricing or maturing in each of a number of periods. Another aspect of these repricing characteristics is the relative magnitude of the repricing for each category of interest earning asset and interest-bearing liability given various changes in market interest rates. Gap analysis gives no indication of the relative magnitude of repricing given various changes in interest rates. Interest rate sensitivity management focuses on the maturity of assets and liabilities and their repricing during periods of changes in market interest rates. Interest rate sensitivity gaps are measured as the difference between the volumes of assets and liabilities in the Company s current portfolio that are subject to repricing at various time horizons.

The following interest rate sensitivity table shows the Company s repricing gaps as of December 31, 2013. In this table transaction deposits, which may be repriced at will by the Company, have been included in the less than 3-month category. The inclusion of all of the transaction deposits in the less than 3-month repricing category causes the Company to appear liability sensitive. Because the Company may reprice its transaction deposits at will, transaction deposits may or may not reprice immediately with changes in interest rates.

Due to the limitations of gap analysis, as described above, the Company does not actively use gap analysis in managing interest rate risk. Instead, the Company relies on the more sophisticated interest rate risk simulation model described above as its primary tool in measuring and managing interest rate risk.

	Repricing within:				
Interest Rate Sensitivity December 31, 2013					
(dollars in thousands)	Less than 3 months	3 6 months	6 12 months	1 5 years	Over 5 years
Interest-earning assets:					
	$ 521,453				

Cash at Federal Reserve and other banks					
Securities	14,309	$ 12,605	$ 23,727	$ 133,758	$ 160,752
Loans	489,422	95,638	140,847	787,606	158,494
Total interest-earning assets	1,025,184	108,243	164,574	921,364	$ 319,246
Interest-bearing liabilities					
Transaction deposits	1,332,337				
Time	99,939	53,565	62,940	72,244	
Other borrowings	6,335				
Junior subordinated debt	41,238				
Total interest-bearing liabilities	$ 1,479,849	$ 53,565	$ 62,940	$ 72,244	
Interest sensitivity gap	$ (454,665)	$ 54,678	$ 101,634	$ 849,120	$ 319,246
Cumulative sensitivity gap	$ (454,665)	$ (399,987)	$ (298,353)	$ 550,767	$ 870,013
As a percentage of earning assets:					
Interest sensitivity gap	(17.9%)	2.1%	4.0%	33.5%	12.6%
Cumulative sensitivity gap	(17.9%)	(15.8%)	(11.8%)	21.7%	34.3%

Liquidity

Liquidity refers to the Company s ability to provide funds at an acceptable cost to meet loan demand and deposit withdrawals, as well as contingency plans to meet unanticipated funding needs or loss of funding sources. These objectives can be met from either the asset or liability side of the balance sheet. Asset liquidity sources consist of the repayments and maturities of loans, selling of loans, short-term money market investments, maturities of securities and sales of securities from the available-for-sale portfolio. These activities are generally summarized as investing activities in the Consolidated Statement of Cash Flows. Net cash used by investing activities totaled $302,897,000 in 2013. Net increases in investment and loan balances used $187,108,000 and $122,109,000 of cash, respectively.

Liquidity may also be generated from liabilities through deposit growth and borrowings. These activities are included under financing activities in the Consolidated Statement of Cash Flows. In 2013, financing activities provide funds totaling $111,280,000 due mainly to a $120,781,000 increase in deposit balances. Dividends paid and a decrease in short-term other borrowings used $6,745,000 and $2,862,000 of funds, respectively. The Bank also had available correspondent banking lines of credit totaling $10,000,000 at December 31, 2013. In addition, at December 31, 2013, the Company had loans and securities available to pledge towards future borrowings from the Federal Home Loan Bank and the Federal Reserve Bank of up to $575,654,000 and $106,856,000, respectively. As of December 31, 2013, the Company had $6,335,000 of other borrowings as described in Note 16 of the consolidated financial statements of the Company and the related notes at Item 8 of this report. While these sources are expected to continue to provide significant amounts of funds in the future, their mix, as well as the possible use of other sources, will depend on future economic and market conditions. Liquidity is also provided or used through the results of operating activities. In 2013, operating activities provided cash of $41,086,000.

The Company s investment securities available for sale plus cash and cash equivalents in excess of reserve requirements totaled $664,656,000 at December 31, 2013, which was 24.2% of total assets at that time. This was down from $880,332,000 and 33.7% at the end of 2012.

It is anticipated that loan demand may be modest during 2014, although such demand will be dictated by economic and competitive conditions. The Company aggressively solicits non-interest bearing demand deposits and money market checking deposits, which are the least sensitive to interest rates. The growth of deposit balances is subject to heightened competition, the success of the Company s sales efforts, delivery of superior customer service and market conditions. The reduction in the federal funds rate and various Federal Reserve interest rate manipulation efforts have resulted in historic low short-term and long-term interest rates, which could impact deposit volumes in the future. Depending on economic conditions, interest rate levels, and a variety of other conditions, deposit growth may be used to fund loans, to reduce short-term borrowings or purchase investment securities. However, due to concerns such as uncertainty in the general economic environment, competition and political uncertainty, loan demand and levels of customer deposits are not certain.

The principal cash requirements of the Company are dividends on common stock when declared. The Company is dependent upon the payment of cash dividends by the Bank to service its commitments. Shareholder dividends are expected to continue subject to the Board s discretion and continuing evaluation of capital levels, earnings, asset quality and other factors. The Company expects that the cash dividends paid by the Bank to the Company will be sufficient to meet this payment schedule. Dividends from the Bank are subject to certain regulatory restrictions.

The maturity distribution of certificates of deposit in denominations of $100,000 or more is set forth in the following table. These deposits are generally more rate sensitive than other deposits and, therefore, are more likely to be withdrawn to obtain higher yields elsewhere if available. The Bank participates in a program wherein the State of California places time deposits with the Bank at the Bank s option. At December 31, 2013, 2012 and 2011, the Bank had $5,000,000, $5,000,000 and $5,000,000, respectively, of these State deposits.

Certificates of Deposit in Denominations of $100,000 or More

	Amounts as of December 31,		
(dollars in thousands)	2013	2012	2011
Time remaining until maturity:			
Less than 3 months	$ 61,205	$ 73,180	$ 82,497
3 months to 6 months	39,580	32,384	49,613
6 months to 12 months	16,772	34,311	46,446
More than 12 months	40,090	40,320	41,818
Total	$ 157,647	$ 180,195	$ 220,374

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Loan demand also affects the Company s liquidity position. The following table presents the maturities of loans, net of deferred loan costs, at December 31, 2013:

	Within One Year	After One But Within 5 Years	After 5 Years	Total
		(dollars in thousands)		
Loans with predetermined interest rates:				
Real estate mortgage	$ 35,687	$ 139,206	$ 216,972	$ 391,865
Consumer	17,550	44,263	44,833	106,646
Commercial	11,754	23,741	7,654	43,149
Real estate construction	8,776	5,484	4,543	18,803
	$ 73,767	$ 212,694	$ 274,002	$ 560,463
Loans with floating interest rates:				
Real estate mortgage	$ 42,347	$ 166,443	$ 507,208	$ 715,998
Consumer	1,657	11,502	263,358	276,517
Commercial	60,060	18,934	9,735	88,729
Real estate construction	5,803	6,029	18,468	30,300
	$ 109,867	$ 202,908	$ 798,769	$ 1,111,544
Total loans	$ 183,634	$ 415,602	$ 1,072,771	$ 1,672,007

The maturity distribution and yields of the investment portfolio at December 31, 2013 is presented in the following table. The timing of the maturities indicated in the table below is based on final contractual maturities. Most mortgage-backed securities return principal throughout their contractual lives. As such, the weighted average life of mortgage-backed securities based on outstanding principal balance is usually significantly shorter than the final contractual maturity indicated below. Yields on tax exempt securities are shown on a tax equivalent basis. At December 31, 2012, the Company had no held-to-maturity securities.

	Within One Year		After One Year but Through Five Years		After Five Years but Through Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
					(dollars in thousands)					
Securities Available for Sale										
Obligations of US government corporations	$ 536	4.44%	$ 1,721	4.81%	$ 29,967	2.61%	$ 64,919	3.80%	$ 97,143	3.45%

and agencies										
Obligations of states andpolitical subdivisions			330	6.32%	4,021	7.09%	1,238	6.85%	5,589	6.99%
Corporate bonds			1,915	1.78%					1,915	1.78%
Total securities available for sale	$ 536	4.44%	$ 3,966	3.44%	$ 33,988	3.15%	$ 66,157	3.85%	$ 104,647	3.61%

	Within One Year		After One Year but Through Five Years		After Five Years but Through Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
	(dollars in thousands)									
<u>Securities Available for Sale</u>										
Obligations of US government corporations and agencies							$ 227,864	2.87%	$ 227,864	2.87%
Obligations of states and political subdivisions							12,640	4.13%	12,640	4.13%
Total securities held to maturity							$ 240,504	2.93%	$ 240,504	2.93%

Off-Balance Sheet Items

The Bank has certain ongoing commitments under operating and capital leases. See Note 18 of the financial statements at Item 8 of this report for the terms. These commitments do not significantly impact operating results. As of December 31, 2013 commitments to extend credit and commitments related to the Bank s deposit overdraft privilege product were the Bank s only financial instruments with off-balance sheet risk. The Bank has not entered into any material contracts for financial derivative instruments such as futures, swaps, options, etc. Commitments to extend credit were $557,987,000 and $560,159,000 at December 31, 2013and 2012, respectively, and represent 33.4% of the total loans outstanding at year-end 2013 versus 35.8% at December 31, 2012. Commitments related to the Bank s deposit overdraft privilege product totaled $68,932,000 and $69,675,000 at December 31, 2013 and 2012, respectively.

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Certain Contractual Obligations

The following chart summarizes certain contractual obligations of the Company as of December 31, 2013:

(dollars in thousands)	Total	Less than one year	1-3 years	3-5 years	More than 5 years
Time deposits	$ 288,688	$ 216,444	$ 57,056	$ 15,186	$ 2
Other collateralized borrowings, fixed rate of 0.05% payable on January 2, 2013	6,335	6,335			
Junior subordinated debt (2)	20,619				20,619
Junior subordinated debt (3)	20,619				20,619
Operating lease obligations	7,767	2,452	2,860	1,220	1,235
Deferred compensation (1)	7,599	1,269	2,009	1,477	2,844
Supplemental retirement plans (1)	4,334	569	945	842	1,978
Total contractual obligations	$ 355,961	$ 227,069	$ 62,870	$ 18,725	$ 47,297

(1) These amounts represent known certain payments to participants under the Company s deferred compensation and supplemental retirement plans. See Note 25 in the financial statements at Item 8 of this report for additional information related to the Company s deferred compensation and supplemental retirement plan liabilities.
(2) Junior subordinated debt, adjustable rate of three-month LIBOR plus 3.05%, callable in whole or in part by the Company on a quarterly basis beginning October 7, 2008, matures October 7, 2033.
(3) Junior subordinated debt, adjustable rate of three-month LIBOR plus 2.55%, callable in whole or in part by the Company on a quarterly basis beginning July 23, 2009, matures July 23, 2034.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See Market Risk Management under Item 7 of this report which is incorporated herein.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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TRICO BANCSHARES

CONSOLIDATED BALANCE SHEETS

	At December 31, 2013	At December 31, 2012
	(in thousands, except share data)	
Assets:		
Cash and due from banks	$ 76,915	$ 81,086
Cash at Federal Reserve and other banks	521,453	667,813
Cash and cash equivalents	598,368	748,899
Investment securities:		
Available for sale	104,647	163,027
Held to maturity	240,504	
Restricted equity securities	9,163	9,647
Loans held for sale	2,270	12,053
Loans	1,672,007	1,564,823
Allowance for loan losses	(38,245)	(42,648)
Total loans, net	1,633,762	1,522,175
Foreclosed assets, net	6,262	7,498
Premises and equipment, net	31,612	26,985
Cash value of life insurance	52,309	50,582
Accrued interest receivable	6,516	6,636
Goodwill	15,519	15,519
Other intangible assets, net	883	1,092
Mortgage servicing rights	6,165	4,552
Indemnification asset	206	1,997
Other assets	35,880	38,607
Total assets	$ 2,744,066	$ 2,609,269
Liabilities and Shareholders Equity:		
Liabilities:		
Deposits:		
Noninterest-bearing demand	$ 789,458	$ 684,833
Interest-bearing	1,621,025	1,604,869
Total deposits	2,410,483	2,289,702
Accrued interest payable	938	1,036
Reserve for unfunded commitments	2,415	3,615
Other liabilities	31,711	35,122
Other borrowings	6,335	9,197
Junior subordinated debt	41,238	41,238

Total liabilities	2,493,120	2,379,910
Commitments and contingencies (Note 18)		
Shareholders equity:		
Common stock, no par value: 50,000,000 shares authorized;issued and outstanding:		
16,076,662 at December 31, 2013	89,356	
16,000,838 at December 31, 2012		85,561
Retained earnings	159,733	141,639
Accumulated other comprehensive income, net of tax	1,857	2,159
Total shareholders equity	250,946	229,359
Total liabilities and shareholders equity	$ 2,744,066	$ 2,609,269

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

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TRICO BANCSHARES

CONSOLIDATED STATEMENTS OF INCOME

	Years ended December 31,		
	2013	2012	2011
	(in thousands, except per share data)		
Interest and dividend income:			
Loans, including fees	$ 97,548	$ 100,496	$ 92,691
Debt securities:			
Taxable	6,349	6,072	8,733
Tax exempt	583	428	524
Dividends	387	105	27
Interest bearing cash at			
Federal Reserve and other banks	1,693	1,615	1,007
Total interest and dividend income	106,560	108,716	102,982
Interest expense:			
Deposits	3,445	4,416	6,559
Other borrowings	4	1,604	2,420
Junior subordinated debt	1,247	1,324	1,259
Total interest expense	4,696	7,344	10,238
Net interest income	101,864	101,372	92,744
(Benefit from) provision for loan losses	(715)	9,423	23,060
Net interest income after provision for loan losses	102,579	91,949	69,684
Noninterest income:			
Service charges and fees	25,257	23,925	23,944
Gain on sale of loans	5,602	6,810	3,037
Commissions on sale of non-deposit investment products	2,983	3,209	2,105
Increase in cash value of life insurance	1,727	1,820	1,885
Bargain purchase gain			7,575
Other	1,260	2,216	4,267
Total noninterest income	36,829	37,980	42,813
Noninterest expense:			
Salaries and related benefits	51,936	49,952	44,203
Other	41,668	48,046	38,512
Total noninterest expense	93,604	97,998	82,715

Income before income taxes	45,804	31,931	29,782
Provision for income taxes	18,405	12,937	11,192
Net income	$ 27,399	$ 18,994	$ 18,590
Earnings per share:			
Basic	$ 1.71	$ 1.19	$ 1.17
Diluted	$ 1.69	$ 1.18	$ 1.16

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

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TRICO BANCSHARES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Years ended December 31,		
	2013	2012	2011
	(in thousands, except per share data)		
Net income	$ 27,399	$ 18,994	$ 18,590
Other comprehensive (loss) income, net of tax:			
Unrealized holding (losses) gains on securities arising during the period	(2,452)	(1,216)	1,504
Change in minimum pension liability	1,750	(2)	1,140
Change in joint beneficiary agreement liability	400	(434)	(143)
Other comprehensive (loss) income	(302)	(1,652)	2,501
Comprehensive income	$ 27,097	$ 17,342	$ 21,091

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

TRICO BANCSHARES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

Years Ended December 31, 2013, 2012 and 2011

	Shares of Common Stock	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
		(in thousands, except share data)			
Balance at December 31, 2010	15,860,138	$ 81,554	$ 117,533	$ 1,310	$ 200,397
Net income			18,590		18,590
Other comprehensive income				2,501	2,501
Stock option vesting		830			830
Stock options forfeited		(114)			(114)
Stock options exercised	296,250	2,428			2,428
Tax benefit of stock options exercised		296			296
Repurchase of common stock	(177,430)	(915)	(1,830)		(2,745)
Dividends paid ($0.36 per share)			(5,742)		(5,742)
Balance at December 31, 2011	15,978,958	$ 84,079	$ 128,551	$ 3,811	$ 216,441
Net income			18,994		18,994
Other comprehensive loss				(1,652)	(1,652)
Stock option vesting		1,083			1,083

Stock options exercised	36,000	430			430
Tax benefit of stock options exercised		44			44
Repurchase of common stock	(14,120)	(75)	(149)		(224)
Dividends paid ($0.36 per share)			(5,757)		(5,757)
Balance at December 31, 2012	16,000,838	$ 85,561	$ 141,639	$ 2,159	$ 229,359
Net income			27,399		27,399
Other comprehensive loss				(302)	(302)
Stock option vesting		1,151			1,151
Stock options forfeited		(22)			(22)
Stock options exercised	248,765	3,240			3,240
Tax benefit of stock options exercised		356			356
Repurchase of common stock	(172,941)	(930)	(2,560)		(3,490)
Dividends paid ($0.42 per share)			(6,745)		(6,745)
Balance at December 31, 2013	16,076,662	$ 89,356	$ 159,733	$ 1,857	$ 250,946

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

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TRICO BANCSHARES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2013	2012	2011
	(in thousands)		
Operating activities:			
Net income	$ 27,399	$ 18,994	$ 18,590
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation of premises and equipment, and amortization	4,623	4,292	3,309
Amortization of intangible assets	209	209	177
(Benefit from) provision for loan losses	(715)	9,423	23,060
Amortization of investment securities premium, net	752	1,151	1,435
Originations of loans for resale	(123,834)	(225,602)	(119,855)
Proceeds from sale of loans originated for resale	137,859	238,352	116,556
Gain on sale of loans	(5,602)	(6,810)	(3,037)
Change in market value of mortgage servicing rights	(253)	2,016	1,107
Provision for losses on foreclosed assets	682	1,728	1,984
Gain on sale of foreclosed assets	(1,640)	(786)	(680)
Loss on disposal of fixed assets	39	420	15
Increase in cash value of life insurance	(1,727)	(1,820)	(1,885)
Gain on life insurance death benefit		(675)	(789)
Stock option vesting expense	1,151	1,083	830
Stock option excess tax benefits	(356)	(44)	(296)
Bargain purchase gain			(7,575)
Deferred income tax expense (benefit)	2,526	(384)	(1,691)
Change in:			
Reserve for unfunded commitments	(1,200)	875	100
Interest receivable	120	676	(181)
Interest payable	(98)	(638)	(477)
Other assets and liabilities, net	1,151	9,603	967
Net cash from operating activities	41,086	52,063	31,664
Investing activities:			
Proceeds from maturities of securities available for sale	53,468	76,764	84,016
Purchases of securities available for sale		(13,815)	(25,456)
Proceeds from maturities of securities held to maturity	4,391		
Purchases of securities held to maturity	(244,967)		
Redemption of restricted equity securities, net	484	963	449
Loan origination and principal collections, net	(59,411)	(44,601)	9,363
Loans purchased	(62,698)		
Proceeds from sale of premises and equipment	12	30	1
Improvement of foreclosed assets	(479)	(983)	

Proceeds from sale of other real estate owned	13,910	17,257	7,632
Purchases of premises and equipment	(8,313)	(10,792)	(3,350)
Life insurance proceeds	706	4,423	
Cash received from acquisitions			80,706
Net cash (used) provided by investing activities	(302,897)	29,246	153,361
Financing activities:			
Net increase (decrease) in deposits	120,781	99,166	98,464
Net change in other borrowings	(2,862)	(63,344)	(11,517)
Stock option excess tax benefits	356	44	296
Repurchase of common stock	(501)		(753)
Dividends paid	(6,745)	(5,757)	(5,742)
Exercise of stock options	251	206	436
Net cash from financing activities	111,280	30,315	81,184
Net change in cash and cash equivalents	(150,531)	111,624	266,209
Cash and cash equivalents and beginning of year	748,899	637,275	371,066
Cash and cash equivalents at end of year	$ 598,368	$ 748,899	$ 637,275
Supplemental disclosure of noncash activities:			
Unrealized (loss) gain on securities available for sale	$ (4,232)	$ (2,096)	$ 2,594
Loans transferred to foreclosed assets	11,717	8,382	6,943
Loans transferred to held-for-sale		9,739	
Market value of shares tendered in-lieu ofcash to pay for exercise of options and/or related taxes	2,989	224	1,992
Supplemental disclosure of cash flow activity:			
Cash paid for interest expense	4,794	7,982	10,715
Cash paid for income taxes	$ 17,395	$ 10,995	16,625
Assets acquired in acquisition			270,304
Liabilities assumed in acquisition			$ 262,729

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

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TRICO BANCSHARES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2012, 2011 and 2010

Note 1 Summary of Significant Accounting Policies

Description of Business and Basis of Presentation

TriCo Bancshares is a California corporation organized to act as a bank holding company for Tri Counties Bank. The Bank is a state-chartered financial institution that is engaged in the general commercial banking business in the California counties of Butte, Contra Costa, Del Norte, Fresno, Glenn, Kern, Lake, Lassen, Madera, Mendocino, Merced, Napa, Nevada, Placer, Sacramento, Shasta, Siskiyou, Stanislaus, Sutter, Tehama, Tulare, Yolo and Yuba. Tri Counties Bank currently operates from 41 traditional branches and 22 in-store branches. The Company also formed two subsidiary business trusts, TriCo Capital Trust I and TriCo Capital Trust II (collectively, the Trusts), to issue trust preferred securities.

The consolidated financial statements are prepared in accordance with accounting policies generally accepted in the United States of America and general practices in the banking industry. The financial statements include the accounts of the Company. All inter-company accounts and transactions have been eliminated in consolidation. For financial reporting purposes, the Company s investments in the Trusts of $1,238,000 are accounted for under the equity method and, accordingly, are not consolidated and are included in other assets on the consolidated balance sheet. The subordinated debentures issued and guaranteed by the Company and held by the Trusts are reflected as debt on the Company s consolidated balance sheet.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, the Company evaluates its estimates, including those related to the adequacy of the allowance for loan losses, investments, intangible assets, income taxes and contingencies. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The allowance for loan losses, indemnification asset, foreclosed assets, goodwill and other intangible assets, income taxes, fair value of assets acquired and liabilities assumed in business combinations, the valuation of securities available-for-sale, and the valuation of mortgage servicing rights are the only accounting estimates that materially affect the Company s consolidated financial statements.

As described in Note 2, the Bank assumed the banking operations of two failed financial institutions from the FDIC under whole bank purchase agreements. The acquired assets and assumed liabilities were measured at estimated fair value values under the acquisition method of accounting. The Company made significant estimates and exercised significant judgment in accounting for the acquisitions. The Company determined loan fair values based on loan file reviews, loan risk ratings, appraised collateral values, expected cash flows and historical loss factors. Foreclosed assets were primarily valued based on appraised values of the repossessed loan collateral. An identifiable intangible was also recorded representing the fair value of the core deposit customer base based on an evaluation of the cost of such deposits relative to alternative funding sources. The fair value of time deposits and borrowings were determined based on the present value of estimated future cash flows using current rates as of the acquisition date.

Significant Group Concentration of Credit Risk

The Company grants agribusiness, commercial, consumer, and residential loans to customers located throughout the northern San Joaquin Valley, the Sacramento Valley and northern mountain regions of California. The Company has a diversified loan portfolio within the business segments located in this geographical area. The Company currently classifies all its operation into one business segment that it denotes as community banking.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold. Net cash flows are reported for loan and deposit transactions and other borrowings.

Investment Securities

The Company classifies its debt and marketable equity securities into one of three categories: trading, available for sale or held to maturity. Trading securities are bought and held principally for the purpose of selling in the near term. Held to maturity securities are those securities which the Company has the ability and intent to hold until maturity. These securities are carried at cost adjusted for amortization of premium and accretion of discount, computed by the effective interest method over their contractual lives. All other securities not included in trading or held to maturity are classified as available for sale. Available for sale securities are recorded at fair value. Unrealized gains and losses, net of the related tax effect, on available for sale securities are reported as a separate component of other accumulated comprehensive income in shareholders equity until realized. Premiums and discounts are amortized or accreted over the life of the related investment security as an adjustment to yield using the effective interest method. Dividend and interest income are recognized when earned. Realized gains and losses are derived from the amortized cost of the security sold. During the years ended December 31, 2013 and 2012, the Company did not have any securities classified as trading. During the three months ended March 31, 2013, and the year ended December 31, 2012, the Company did not have any securities classified as held to maturity.

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The Company assesses other-than-temporary impairment (OTTI) based on whether it intends to sell a security or if it is likely that the Company would be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity. For debt securities, if we intend to sell the security or it is likely that we will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If we do not intend to sell the security and it is not likely that we will be required to sell the security but we do not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income (OCI). Impairment losses related to all other factors are presented as separate categories within OCI. The accretion of the amount recorded in OCI increases the carrying value of the investment and does not affect earnings. If there is an indication of additional credit losses the security is re-evaluated according to the procedures described above. No OTTI losses were recognized during the years ended December 31, 2013 and 2012.

Restricted Equity Securities

Restricted equity securities represent the Company s investment in the stock of the Federal Home Loan Bank of San Francisco (FHLB) and are carried at par value, which reasonably approximates its fair value. While technically these are considered equity securities, there is no market for the FHLB stock. Therefore, the shares are considered as restricted investment securities. Management periodically evaluates FHLB stock for other-than-temporary impairment. Management s determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB.

As a member of the FHLB system, the Company is required to maintain a minimum level of investment in FHLB stock based on specific percentages of its outstanding mortgages, total assets, or FHLB advances. The Company may request redemption at par value of any stock in excess of the minimum required investment. Stock redemptions are at the discretion of the FHLB.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by aggregate outstanding commitments from investors of current investor yield requirements. Net unrealized losses are recognized through a valuation allowance by charges to noninterest income.

Mortgage loans held for sale are generally sold with the mortgage servicing rights retained by the Company. Gains or losses on the sale of loans that are held for sale are recognized at the time of the sale and determined by the difference between net sale proceeds and the net book value of the loans less the estimated fair value of any retained mortgage servicing rights.

Loans and Allowance for Loan Losses

Loans originated by the Company, i.e., not purchased or acquired in a business combination, are referred to as originated loans. Originated loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal amount outstanding, net of deferred loan fees and costs. Loan origination and commitment fees and certain direct loan origination costs are deferred, and the net amount is amortized as an adjustment of the related loan s yield over the actual life of the loan. Originated loans on which the accrual of interest has been discontinued are designated as nonaccrual loans.

Originated loans are placed in nonaccrual status when reasonable doubt exists as to the full, timely collection of interest or principal, or a loan becomes contractually past due by 90 days or more with respect to interest or principal and is not well secured and in the process of collection. When an originated loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of Management, the loan is estimated to be fully collectible as to both principal and interest.

An allowance for loan losses for originated loans is established through a provision for loan losses charged to expense. The allowance is maintained at a level which, in Management s judgment, is adequate to absorb probable incurred credit losses inherent in the loan portfolio as of the balance sheet date. Originated loans and deposit related overdrafts are charged against the allowance for loan losses when Management believes that the collectability of the principal is unlikely or, with respect to consumer installment loans, according to an established delinquency schedule. The allowance is an amount that Management believes will be adequate to absorb probable losses inherent in existing loans and leases, based on evaluations of the collectability, impairment and prior loss experience of loans and leases. The evaluations take into consideration such factors as changes in the nature and size of the portfolio, overall portfolio quality, loan concentrations, specific problem loans, and current economic conditions that may affect the borrower s ability to pay. The Company defines an originated loan as impaired when it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired originated loans are measured based on the present value of expected future cash flows discounted at the loan s original effective interest rate. As a practical expedient, impairment may be measured based on the loan s observable market price or the fair value of the collateral if the loan is collateral dependent. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through a valuation allowance.

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In situations related to originated loans where, for economic or legal reasons related to a borrower s financial difficulties, the Company grants a concession for other than an insignificant period of time to the borrower that the Company would not otherwise consider, the related loan is classified as a troubled debt restructuring (TDR). The Company strives to identify borrowers in financial difficulty early and work with them to modify to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where the Company grants the borrower new terms that result in the loan being classified as a TDR, the Company measures any impairment on the restructuring as noted above for impaired loans. TDR loans are classified as impaired until they are fully paid off or charged off. Loans that are in nonaccrual status at the time they become TDR loans, remain in nonaccrual status until the borrower demonstrates a sustained period of performance which the Company generally believes to be six consecutive months of payments, or equivalent. Otherwise, TDR loans are subject to the same nonaccrual and charge-off policies as noted above with respect to their restructured principal balance.

Credit risk is inherent in the business of lending. As a result, the Company maintains an allowance for loan losses to absorb losses inherent in the Company s originated loan portfolio. This is maintained through periodic charges to earnings. These charges are included in the Consolidated Statements of Income as provision for loan losses. All specifically identifiable and quantifiable losses are immediately charged off against the allowance. However, for a variety of reasons, not all losses are immediately known to the Company and, of those that are known, the full extent of the loss may not be quantifiable at that point in time. The balance of the Company s allowance for originated loan losses is meant to be an estimate of these unknown but probable losses inherent in the portfolio.

The Company formally assesses the adequacy of the allowance for originated loan losses on a quarterly basis. Determination of the adequacy is based on ongoing assessments of the probable risk in the outstanding originated loan portfolio, and to a lesser extent the Company s originated loan commitments. These assessments include the periodic re-grading of credits based on changes in their individual credit characteristics including delinquency, seasoning, recent financial performance of the borrower, economic factors, changes in the interest rate environment, growth of the portfolio as a whole or by segment, and other factors as warranted. Loans are initially graded when originated. They are re-graded as they are renewed, when there is a new loan to the same borrower, when identified facts demonstrate heightened risk of nonpayment, or if they become delinquent. Re-grading of larger problem loans occurs at least quarterly. Confirmation of the quality of the grading process is obtained by independent credit reviews conducted by consultants specifically hired for this purpose and by various bank regulatory agencies.

The Company s method for assessing the appropriateness of the allowance for originated loan losses includes specific allowances for impaired originated loans and leases, formula allowance factors for pools of credits, and allowances for changing environmental factors (e.g., interest rates, growth, economic conditions, etc.). Allowance factors for loan pools were based on historical loss experience by product type and prior risk rating.

During the three months ended March 31, 2012, management changed some of the assumptions utilized in the Allowance for Loan Losses estimate calculation. These changes were intended to more accurately reflect the current risk in the loan portfolio and to better estimate the losses inherent but not yet quantifiable. These changes included the conversion to a historical loss migration analysis intended to better determine the appropriate formula reserve ratio by loan category and risk rating, the addition of an environmental factor related to the delinquency rate of loans not classified as impaired by loan category, the elimination of an unspecified reserve allocation previously intended to account for imprecision inherent in the overall calculation, and the reclassification of risk rating of certain consumer loans based on current credit score in an attempt to better identify the risk in the portfolio. The financial effect of these changes resulted in a net reduction in the calculated Allowance for Loan Losses of $1,388,000 during the three months ended March 31, 2012. Allowances for impaired loans are based on analysis of individual credits. Allowances for changing environmental factors are Management s best estimate of the probable impact these changes have had on the originated loan portfolio as a whole. The allowance for originated loans is included in the allowance for loan losses.

During the three months ended March 31, 2013, the Company changed the method it uses to estimate net sale proceeds from real estate collateral sales when calculating the allowance for loan losses associated with impaired real estate collateral dependent loans. Previously, the Company used the greater of fifteen percent or actual estimated selling costs. Currently, the Company uses the actual estimated selling costs, and an adjustment to appraised value based on the age of the appraisal. These changes are intended to more accurately reflect the estimated net sale proceeds from the sale of impaired collateral dependent real estate loans. This change in methodology resulted in the allowance for loan losses as of March 31, 2013 being $494,000 more than it would have been without this change in methodology.

During the three months ended June 30, 2013, the Company modified its loss migration analysis methodology used to determine the formula allowance factors. When the Company originally established its loss migration analysis methodology during the quarter ended March 31, 2012, it reviewed the loss experience of each rolling twelve month period over the previous three years in order to calculate an annualized loss rate by loan category and risk rating. The use of three years of loss experience data was originally used because that was the extent of the detailed loss data, by loan category and risk rating that was available at the time. This three year historical look-back period was used through the quarter ended March 31, 2013. Starting with the quarter ended June 30, 2013, the Company reviews all available detailed loss experience data, going back to, and including, the twelve month period ended June 30, 2009, and does not limit the look-back period to the most recent three years of historical loss data. Using this data, the Company calculates loss factors for each quarter from the quarter ended June 30, 2009 to the most recent quarter. The Company then calculates a weighted average formula allowance factor for each loan category and risk rating with the most recent quarterly loss factor being weighted 125%, the quarter ended June 30, 2009 loss factor being weighted 75%, and the loss factors for all the quarters between the most recent quarter and the quarter ended June 30, 2009, being weighted on a linear scale from 75% to 125%. This change is intended to more accurately reflect the risk inherent in the loan portfolio by considering historical loss data for all years as the data for new periods becomes available. This change in methodology resulted in the allowance for loan losses as of June 30, 2013 being $1,314,000 more than it would have been without this change in methodology.

During the three months ended September 30, 2013, the Company modified its methodology used to determine the allowance for changing environmental factors. Previously, the Company compared the current value of each environmental factor to a fixed baseline value. The deviation of the current value from the baseline value was then multiplied by a conversion factor to determine the required allowance related to each environmental factor. As of September 30, 2013, the Company replaced the fixed baseline values with average baseline values derived from historical averages, and adjusted the conversion factors. This change is intended to more accurately reflect the risk inherent in the portfolio by recognizing that baseline, or normal, levels for environmental factors may change over time. This change in methodology resulted in the allowance for loan losses as of September 30, 2013 being $1,665,000 more than it would have been without this change in methodology.

Loans purchased or acquired in a business combination are referred to as acquired loans. Acquired loans are valued as of the acquisition date in accordance with Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Topic 805, *Business Combinations*. Loans acquired with evidence of credit deterioration since origination for which it is probable that all contractually required payments will not be collected are referred to as purchased credit impaired (PCI) loans. PCI loans are accounted for under FASB ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. Under FASB ASC Topic 805 and FASB ASC Topic 310-30, PCI loans are recorded at fair value at acquisition date, factoring in credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for loan losses is not carried over or recorded as of the acquisition date. Fair value is defined as the present value of the future estimated principal and interest payments of the loan, with the discount rate used in the present value calculation representing the estimated effective yield of the loan. Default rates, loss severity, and prepayment speed assumptions are periodically reassessed and our estimate of future payments is adjusted accordingly. The difference between contractual future payments and estimated future payments is referred to as the nonaccretable difference. The difference between estimated future payments and the present value of the estimated future payments is referred to as the accretable yield. The accretable yield represents the amount that is expected to be recorded as interest income over the remaining life of the loan. If after acquisition, the Company determines that the estimated future cash flows of a PCI loan are expected to be more than originally estimated, an increase in the discount rate (effective yield) would be made such that the newly increased accretable yield would be recognized, on a level yield basis, over the remaining estimated life of the loan. If, after acquisition, the Company determines that the estimated future cash flows of a PCI loan are expected to be less than previously estimated, the discount rate would first be reduced until the present value of the reduced cash flow estimate equals the previous present value however, the discount rate may not be lowered below its original level at acquisition. If the discount rate has been lowered to its original level and the present value has not been sufficiently lowered, an allowance for loan loss would be established through a provision for loan losses charged to expense to decrease the present value to the required level. If the estimated cash flows improve after an allowance has been established for a loan, the allowance may be partially or fully reversed depending on the improvement in the estimated cash flows. Only after the allowance has been fully reversed may the discount rate be increased. PCI loans are put on nonaccrual status when cash flows cannot be reasonably estimated. PCI loans on nonaccrual status are accounted for using the cost recovery method or cash basis method of income recognition. PCI loans are charged off when evidence suggests cash flows are not recoverable. Foreclosed assets from PCI loans are recorded in foreclosed assets at fair value with the fair value at time of foreclosure representing cash flow from the loan. ASC 310-30 allows PCI loans with similar risk characteristics and acquisition time frame to be pooled and have their cash flows aggregated as if they were one loan. The Company elected to use the pooled method of ASC 310-30 for PCI other loans in the acquisition of certain assets and liabilities of Granite Community Bank (Granite) and Citizens Bank of Northern California (Citizens).

Acquired loans that are not PCI loans are referred to as purchased not credit impaired (PNCI) loans. PNCI loans are accounted for under FASB ASC Topic 310-20, *Receivables Nonrefundable Fees and Other Costs,* in which interest income is accrued on a level-yield basis for performing loans. For income recognition purposes, this method assumes that all contractual cash flows will be collected, and no allowance for loan losses is established at the time of acquisition. Post-acquisition date, an allowance for loan losses may need to be established for acquired loans through a provision charged to earnings for credit losses incurred subsequent to acquisition. Under ASC 310-20, the loss would be measured based on the probable shortfall in relation to the contractual note requirements, consistent with our allowance for loan loss policy for similar loans.

Throughout these financial statements, and in particular in Note 4 and Note 5, when we refer to Loans or Allowance for loan losses we mean all categories of loans, including Originated, PNCI, PCI cash basis, and PCI other. When we are not referring to all categories of loans, we will indicate which we are referring to Originated, PNCI, PCI cash basis, or PCI other.

When referring to PNCI and PCI loans we will use the terms nonaccretable difference, accretable yield, or purchase discount. Nonaccretable difference is the difference between undiscounted contractual cash flows due and undiscounted cash flows we expect to collect, or put another way, it is the undiscounted contractual cash flows we do not expect to collect. Accretable yield is the difference between undiscounted cash flows we expect to collect and the value at which we have recorded the loan on our financial statements. On the date of acquisition, all purchased loans are recorded on our consolidated financial statements at estimated fair value. Purchase discount is the difference between the estimated fair value of loans on the date of acquisition and the principal amount owed by the borrower, net of charge offs, on the date of acquisition. We may also refer to discounts to principal balance of loans owed, net of charge-offs. Discounts to principal balance of loans owed, net of charge-offs is the difference between principal balance of loans owed, net of charge-offs, and loans as recorded on our financial statements. Discounts to principal balance of loans owed, net of charge-offs arise from purchase discounts, and equal the purchase discount on the acquisition date.

Loans are also categorized as covered or noncovered. Covered loans refer to loans covered by a Federal Deposit Insurance Corporation (FDIC) loss sharing agreement. Noncovered loans refer to loans not covered by a FDIC loss sharing agreement.

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Foreclosed Assets

Foreclosed assets include assets acquired through, or in lieu of, loan foreclosure. Foreclosed assets are held for sale and are initially recorded at fair value less estimated costs to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, management periodically performs valuations and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other noninterest expense. Gain or loss on sale of foreclosed assets is included in noninterest income. Foreclosed assets that are not subject to a FDIC loss-share agreement are referred to as noncovered foreclosed assets.

Foreclosed assets acquired through FDIC-assisted acquisitions that are subject to a FDIC loss-share agreement, and all assets acquired via foreclosure of covered loans are referred to as covered foreclosed assets. Covered foreclosed assets are reported exclusive of expected reimbursement cash flows from the FDIC. Foreclosed covered loan collateral is transferred into covered foreclosed assets at the loan s carrying value, inclusive of the acquisition date fair value discount.

Covered foreclosed assets are initially recorded at estimated fair value less estimated costs to sell on the acquisition date based on similar market comparable valuations less estimated selling costs. Any subsequent valuation adjustments due to declines in fair value will be charged to noninterest expense, and will be mostly offset by noninterest income representing the corresponding increase to the FDIC indemnification asset for the offsetting loss reimbursement amount. Any recoveries of previous valuation adjustments will be credited to noninterest expense with a corresponding charge to noninterest income for the portion of the recovery that is due to the FDIC.

Premises and Equipment

Land is carried at cost. Land improvements, buildings and equipment, including those acquired under capital lease, are stated at cost less accumulated depreciation and amortization. Depreciation and amortization expenses are computed using the straight-line method over the estimated useful lives of the related assets or lease terms. Asset lives range from 3-10 years for furniture and equipment and 15-40 years for land improvements and buildings.

Goodwill and Other Intangible Assets

Goodwill represents the excess of costs over fair value of net assets of businesses acquired. Goodwill and other intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment.

The Company has an identifiable intangible asset consisting of core deposit intangibles (CDI). CDI are amortized over their respective estimated useful lives, and reviewed for impairment.

Impairment of Long-Lived Assets and Goodwill

Long-lived assets, such as premises and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the consolidated balance sheet.

As of December 31 of each year, goodwill is tested for impairment, and is tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset s fair value. This determination is made at the reporting unit level. The Company may choose to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, the Company determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then goodwill is deemed not to be impaired. However, if the Company concludes otherwise, or if the Company elected not to first assess qualitative factors, then the Company performs the first step of a two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. Second, if the carrying amount of the reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit s goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Currently, and historically, the Company is comprised of only one reporting unit that operates within the business segment it has identified as community banking . Goodwill was not impaired as of December 31, 2013 because the fair value of the reporting unit exceeded its carrying value.

Mortgage Servicing Rights

Mortgage servicing rights (MSR) represent the Company s right to a future stream of cash flows based upon the contractual servicing fee associated with servicing mortgage loans. Our MSR arise from residential mortgage loans that we originate and sell, but retain the right to service the loans. The net gain from the retention of the servicing right is included in gain on sale of loans in noninterest income when the loan is sold. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. Servicing fees are recorded in noninterest income when earned.

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The Company accounts for MSR at fair value. The determination of fair value of our MSR requires management judgment because they are not actively traded. The determination of fair value for MSR requires valuation processes which combine the use of discounted cash flow models and extensive analysis of current market data to arrive at an estimate of fair value. The cash flow and prepayment assumptions used in our discounted cash flow model are based on empirical data drawn from the historical performance of our MSR, which we believe are consistent with assumptions used by market participants valuing similar MSR, and from data obtained on the performance of similar MSR. The key assumptions used in the valuation of MSR include mortgage prepayment speeds and the discount rate. These variables can, and generally will, change from quarter to quarter as market conditions and projected interest rates change. The key risks inherent with MSR are prepayment speed and changes in interest rates. The Company uses an independent third party to determine fair value of MSR.

Indemnification Asset

The Company accounts for amounts receivable under its loss-share agreements entered into with the FDIC in connection with its purchase and assumption of certain assets and liabilities of Granite as indemnification assets in accordance with FASB ASC Topic 805, *Business Combinations*. FDIC indemnification assets are initially recorded at fair value, based on the discounted value of expected future cash flows under the loss-share agreements. The difference between the fair value and the undiscounted cash flows the Company expects to collect from the FDIC will be accreted into noninterest income over the life of the FDIC indemnification asset. FDIC indemnification assets are reviewed quarterly and adjusted for any changes in expected cash flows based on recent performance and expectations for future performance of the covered portfolios. These adjustments are measured on the same basis as the related covered loans and covered other real estate owned. Any increases in cash flow of the covered assets over those expected will reduce the FDIC indemnification asset and any decreases in cash flow of the covered assets under those expected will increase the FDIC indemnification asset. Increases and decreases to the FDIC indemnification asset are recorded as adjustments to noninterest income.

Reserve for Unfunded Commitments

The reserve for unfunded commitments is established through a provision for losses unfunded commitments charged to noninterest expense. The reserve for unfunded commitments is an amount that Management believes will be adequate to absorb probable losses inherent in existing commitments, including unused portions of revolving lines of credits and other loans, standby letters of credits, and unused deposit account overdraft privilege. The reserve for unfunded commitments is based on evaluations of the collectability, and prior loss experience of unfunded commitments. The evaluations take into consideration such factors as changes in the nature and size of the loan portfolio, overall loan portfolio quality, loan concentrations, specific problem loans and related unfunded commitments, and current economic conditions that may affect the borrower s or depositor s ability to pay.

During the three months ended June 30, 2013, the Company modified the methodology employed to estimate potential losses on unfunded commitments. Similar to the Allowance for Loan Losses, the Company performs a migration analysis of historical loss experience. Prior to this quarter, the loss experience of each quarter over the previous three years was reviewed in order to calculate an annualized loss rate by loan category. Going forward, the Company has chosen to review all loss experience available since the conversion to a loss migration analysis. This change is intended to more accurately reflect the risk inherent in the unfunded commitments and appropriately consider all losses incurred in prior years. This change in methodology resulted in the reserve for unfunded commitments as of June 30, 2013 being $335,000 more than it would have been without this change in methodology.

Income Taxes

The Company s accounting for income taxes is based on an asset and liability approach. The Company recognizes the amount of taxes payable or refundable for the current year, and deferred tax assets and liabilities for the future tax consequences that have been recognized in its financial statements or tax returns. The measurement of tax assets and liabilities is based on the provisions of enacted tax laws. A valuation allowance, if needed, reduces deferred tax assets to the expected amount most likely to be realized. Realization of deferred tax assets is dependent upon the generation of a sufficient level of future taxable income and recoverable taxes paid in prior years. Although realization is not assured, management believes it is more likely than not that all of the deferred tax assets will be realized. Interest and/or penalties related to income taxes are reported as a component of noninterest income.

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under credit card arrangements, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded when they are funded.

Geographical Descriptions

For the purpose of describing the geographical location of the Company s loans, the Company has defined northern California as that area of California north of, and including, Stockton; central California as that area of the state south of Stockton, to and including, Bakersfield; and southern California as that area of the state south of Bakersfield.

Reclassifications

Certain amounts reported in previous consolidated financial statements have been reclassified to conform to the presentation in this report. These reclassifications did not affect previously reported net income or total shareholders equity.

Recent Accounting Pronouncements

FASB issued Accounting Standards Update (ASU) No. 2012-06, *Business Combinations (Topic 805): Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution.* ASU 2012-06 requires that when a reporting entity recognizes an indemnification asset (in accordance with Subtopic 805-20) as a result of a government-assisted acquisition of a financial institution and subsequently a change in the cash flows expected to be collected on the indemnification asset occurs (as a result of a change in cash flows expected to be collected on the assets subject to indemnification), the reporting entity should subsequently account for the change in the measurement of the indemnification asset on the same basis as the change in the assets subject to indemnification. Any amortization of changes in value should be limited to the contractual term of the indemnification agreement (that is, the lesser of the term of the indemnification agreement and the remaining life of the indemnified assets). The Company adopted this Standard on January 1, 2013, and the adoption did not have a significant impact on the Company s consolidated financial statements.

FASB issued ASU No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.* ASU 2013-02 amends recent guidance related to the reporting of comprehensive income to enhance the reporting of reclassifications out of accumulated other comprehensive income. The Company adopted this Standard on January 1, 2013, and the adoption did not have a significant impact on the Company s consolidated financial statements.

FASB issued ASU No. 2014-04, *Receivables (Topic 310): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.* ASU 2014-04 clarifies when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The Update is effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Update is not expected to have a significant impact on the Company s consolidated financial statements.

Note 2 - Business Combinations

On January 21, 2014, TriCo announced that it had entered into an Agreement and Plan of Merger and Reorganization under which it would acquire North Valley Bancorp. North Valley Bancorp shareholders will receive a fixed exchange ratio of 0.9433 shares of TriCo common stock for each share of North Valley Bancorp common stock, which would provide North Valley Bancorp shareholders with aggregate ownership, on a pro forma basis, of approximately 28.6% of the common stock of the combined company. Based on TriCo s closing stock price of $27.66 on January 17, 2014, North Valley Bancorp shareholders would have received consideration valued at approximately $26.09 per share.

The merger will not be completed unless a number of customary closing conditions are met, including, among others, approval of the merger by shareholders of both companies, the registration of the offering of the TriCo common stock to the North Valley Bancorp shareholders under the Securities Act of 1933, receipt of required regulatory and other approvals and the expiration of applicable statutory waiting periods, the accuracy of specified representations and warranties of each party, the receipt of tax opinions confirming certain tax aspects of the merger, North Valley Bancorp s satisfaction of certain financial measures shortly prior to closing, and the absence of any injunctions or other legal restraints. If the Merger Agreement is terminated, under certain circumstances, TriCo could be required to pay a termination fee to North Valley Bancorp equal to $3,800,000.

TriCo has agreed to appoint three North Valley Bancorp directors to TriCo s board upon closing of the merger. The merger is expected to be completed in the second or third quarter of 2014, subject to approval of the merger by shareholders of both companies, receipt of required regulatory and other approvals and satisfaction of customary closing conditions.

North Valley Bancorp, headquartered in Redding, California, is the parent of North Valley Bank and had approximately $917.8 million in assets and 22 commercial banking offices in Shasta, Humboldt, Del Norte, Mendocino, Yolo, Sonoma, Placer and Trinity Counties in Northern California at December 31, 2013. In connection with the acquisition, North Valley Bank will merge into Tri Counties Bank.

As of December 31, 2013, on a pro forma consolidated basis with North Valley Bancorp, TriCo would have had approximately $3.61 billion in assets.

On September 23, 2011, the California Department of Financial Institutions closed Citizens Bank of Northern California, Nevada City, California and appointed the FDIC as receiver. That same date, the Bank assumed the banking operations of Citizens from the FDIC under a whole bank purchase and assumption agreement without loss sharing. With this agreement, the Bank added one administration building and seven traditional bank branches, including two in Grass Valley, and one in each of Nevada City, Penn Valley, Lake of the Pines, Truckee, and Auburn, California. This acquisition is consistent with the Bank s community banking expansion strategy and provides further opportunity to fill in the Bank s market presence in the Northern California market.

The assets acquired and liabilities assumed for the Citizens acquisition have been accounted for under the acquisition method of accounting (formerly the purchase method). The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the acquisition date. The fair values of the assets acquired and liabilities assumed were determined based on the requirements of the Fair Value Measurements and Disclosures topic of the FASB ASC. The tax treatment of FDIC assisted acquisitions is complex and subject to interpretations that may result in future adjustments of deferred taxes as of the acquisition date. The terms of the agreement provide for the FDIC to indemnify the Bank against claims with respect to liabilities of Citizens not assumed by the Bank and certain other types of claims identified in the agreement.

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A summary of the net assets received in the Citizens acquisition, at their estimated fair values, is presented below:

(in thousands)	Citizens September 23, 2011
Asset acquired:	
Cash and cash equivalents	$ 80,707
Securities available-for-sale	9,353
Restricted equity securities	1,926
Loans	167,484
Core deposit intangible	898
Foreclosed assets	8,412
Other assets	1,524
Total assets acquired	$ 270,304
Liabilities assumed:	
Deposits	$ 239,899
Other borrowings	22,038
Other liabilities	792
Total liabilities assumed	$ 262,729
Net assets acquired/bargain purchase gain	$ 7,575

In FDIC-assisted transactions, only certain assets and liabilities are transferred to the acquirer and, depending on the nature and amount of the acquirer s bid, the FDIC may be required to make a cash payment to the acquirer. In the Citizens acquisition, net assets with a cost basis of $26,682,000 were transferred to the Bank. In the Citizens acquisition, the Company recorded a bargain purchase gain of $7,575,000 representing the excess of the estimated fair value of the assets acquired over the estimated fair value of the liabilities assumed.

A summary of the estimated fair value adjustments resulting in the bargain purchase gain in the Citizens acquisition are presented below:

(in thousands)	Citizens September 23, 2011
Cost basis net assets acquired	$ 26,682
Cash payment received from FDIC	44,140
Fair value adjustments:	
Cash and cash equivalents	539
Loans	(57,745)
Foreclosed assets	(5,609)
Core deposit intangible	898
Deposits	(382)
Borrowings	(28)

Other		(920)
Bargain purchase gain	$	7,575

The Bank acquired only certain assets and assumed certain liabilities of Citizens. A significant portion of Citizens s operations, its facilities and its central operations and administrative functions were not retained by the Bank. Therefore, disclosure of supplemental pro forma financial information, especially prior period comparison is deemed neither practical nor meaningful given the troubled nature of Citizens prior to the date of acquisition. The Bank did not immediately acquire all the banking facilities, furniture or equipment of Citizens as part of the purchase and assumption agreement. However, the Bank had the option to lease the real estate and purchase the furniture and equipment from the FDIC. The term of this option expired 90 days from the acquisition date. Prior to the expiration of the option, The Bank agreed to purchase essentially all of the furniture and equipment, and assume all of the property leases except for the administration building and Citizen s Auburn branch. During the three months ended March 31, 2012, the Bank transferred the operations of Citizen s Auburn branch to the Bank s existing branch in Auburn, and vacated the Citizen s administration building.

The Company identified the loans acquired in the Citizens acquisition as either PNCI or PCI loans. The Company identified certain of the Citizens PCI loans as having cash flows that were not reasonably estimable and elected to place these loans in nonaccrual status under the cash basis method for income recognition (PCI cash basis loans). The Company elected to use the ASC 310-30 pooled method of accounting for all other Citizens PCI loans (PCI other loans).

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The following table presents a reconciliation of the undiscounted contractual cash flows, nonaccretable difference, accretable yield, fair value, purchase discount, and principal balance of loans for the various categories of Citizens PNCI and PCI loans as of the acquisition date. For PCI loans, the purchase discount does not necessarily represent cash flows to be collected as a portion of it is a nonaccretable difference:

	Citizens Loans	September 23, 2011		
(in thousands)	PNCI	PCI - other	PCI - cash basis	Total
Undiscounted contractual cash flows	$ 230,106	$ 69,346	$ 35,205	$ 334,657
Undiscounted cash flows not expectedto be collected (nonaccretable difference)		(26,846)	(24,517)	(51,363)
Undiscounted cash flows expected to be collected	230,106	42,500	10,688	283,295
Accretable yield at acquisition	(105,664)	(10,146)		(115,810)
Estimated fair value of loans acquired at acquisition	124,442	32,354	10,688	167,484
Purchase discount	20,364	23,207	14,174	57,745
Principal balance loans acquired	$ 144,806	$ 55,561	$ 24,862	$ 225,229

In estimating the fair value of Citizens PNCI loans at the acquisition date, the Company calculated the contractual amount and timing of undiscounted principal and interest payments on an individual loan basis and then discounted those cash flows using an appropriate market rate of interest adjusted for liquidity and credit loss risks inherent in each loan. The Citizens PNCI loans expected accretable yield above represents undiscounted interest, and along with the purchase discount, is accounted for using an effective interest method consistent with our accounting for originated loans.

In estimating the fair value of Citizens PCI cash basis loans at the acquisition date, the Company calculated the contractual amount and timing of undiscounted principal and interest payments and estimated the amount of undiscounted expected principal recovery using historic loss rates or estimated collateral values if applicable. The difference between these two amounts represents the nonaccretable difference. The Company used its estimate of the amount of undiscounted expected principal recovery as the fair value of the Citizens PCI cash basis loans, and placed these loans in nonaccrual status. Interest income and principal reductions on these PCI cash basis loans are recorded only when they are received. At each financial reporting date, the carrying value of each PCI cash basis loan is compared to an updated estimate of expected principal payment or recovery for each loan. To the extent that the loan carrying amount exceeds the updated expected principal payment or recovery, a provision for loan loss would be recorded as a charge to income and an allowance for loan loss established.

In estimating the fair value of Citizens PCI other loans at the acquisition date, the Company calculated the contractual amount and timing of undiscounted principal and interest payments and estimated the amount and timing of undiscounted expected principal and interest payments. The difference between these two amounts represents the nonaccretable difference. On the acquisition date, the amount by which the undiscounted expected cash flows exceed the estimated fair value of the acquired loans is the accretable yield . The accretable yield is then measured at each financial reporting date and represents the difference between the remaining undiscounted expected cash flows and the current carrying value of the loans. For PCI loans the accretable yield is accreted into interest income over the life of the estimated remaining cash flows. For further information regarding the accounting for PCI other loans, and acquired loans in general, see the discussion under the heading Loans and Allowance for Loan Losses in Note 1 above.

The operations of Citizens, included in the Company s operating results from September 23, 2011 to December 31, 2011, added approximately $6,171,000 and $54,000 to interest income and interest expense, respectively, $1,462,000 to provision for loan losses, $8,029,000 to noninterest income, including a bargain purchase gain of $7,575,000, and $1,865,000 to noninterest expense. Included in the $6,171,000 of Citizens related interest income recorded from September 23, 2011 to December 31, 2011, is $3,146,000 of interest income from fair value discount accretion. Citizens results of operations prior to the acquisition are not included in the Company s operating results. As of December 31, 2011, nonrecurring expenses related to the Citizens acquisition were insignificant.

During the three months ended March 31, 2012, the Company completed the conversion of Citizens information and data processing systems to the Bank s systems, and consolidated the Citizens Auburn branch into the Bank s existing Auburn branch. The operations of Citizens, included in the Company s operating results from January 1, 2012 to December 31, 2012, added approximately $17,832,000 and ($20,000) to interest income and interest expense, respectively, $3,844,000 to provision for loan losses, $2,584,000 to noninterest income, and $5,785,000 to noninterest expense. Included in the $17,832,000 of Citizens related interest income recorded from January 1, 2012 to December 31, 2012, is $7,572,000 of interest income from fair value discount accretion. Included in the $2,584,000 of Citizens related noninterest income recorded from January 1, 2012 to December 31, 2012, is a $230,000 loss on disposal of fixed assets related to the system conversion noted above. Included in the $5,785,000 of Citizens related noninterest expense recorded from January 1, 2012 to December 31, 2012, is $415,000 of outside data processing expenses related to the system conversion noted above. Such operating results are not necessarily indicative of future operating results.

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Note 3 Investment Securities

The amortized cost and estimated fair values of investments in debt and equity securities are summarized in the following tables:

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Securities Available for Sale				
Obligations of U.S. government corporations and agencies	$ 93,055	$ 4,445	$ (357)	$ 97,143
Obligations of states and political subdivisions	5,513	77	(1)	5,589
Corporate debt securities	1,877	38		1,915
Total securities available for sale	$ 100,445	$ 4,560	$ (358)	$ 104,647
Securities Held to Maturity				
Obligations of U.S. government corporations and agencies	$ 227,864	$ 298	$ (5,540)	$ 222,622
Obligations of states and political subdivisions	12,640		(1,455)	11,185
Total securities held to maturity	$ 240,504	$ 298	$ (6,995)	$ 233,807

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Securities Available for Sale				
Obligations of U.S. government corporations and agencies	$ 143,633	$ 8,068		$ 151,701
Obligations of states and political subdivisions	9,098	323		9,421
Corporate debt securities	1,862	43		1,905
Total securities available for sale	$ 154,593	$ 8,434		$ 163,027

The Company had no investment securities held to maturity at December 31, 2012.

No investment securities were sold during 2013, 2012, or 2011. Investment securities with an aggregate carrying value of $62,064,000 and $66,911,000 at December 31, 2013 and 2012, respectively, were pledged as collateral for specific borrowings, lines of credit and local agency deposits.

The amortized cost and estimated fair value of debt securities at December 31, 2013 by contractual maturity are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. At December 31, 2013, obligations of U.S.

government corporations and agencies with a cost basis totaling $320,919,000 consist almost entirely of mortgage-backed securities whose contractual maturity, or principal repayment, will follow the repayment of the underlying mortgages. For purposes of the following table, the entire outstanding balance of these mortgage-backed securities issued by U.S. government corporations and agencies is categorized based on final maturity date. At December 31, 2013, the Company estimates the average remaining life of these mortgage-backed securities issued by U.S. government corporations and agencies to be approximately 5.6 years. Average remaining life is defined as the time span after which the principal balance has been reduced by half.

Investment Securities	Available for Sale		Held to Maturity	
(In thousands)	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year	$ 505	$ 536		
Due after one year through five years	3,819	3,966		
Due after five years through ten years	33,017	33,988		
Due after ten years	63,104	66,157	$ 240,504	$ 233,807
Totals	$ 100,445	$ 104,647	$ 240,504	$ 233,807

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Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows:

	Less than 12 months		12 months or more		Total	
December 31, 2013	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
			(in thousands)			
Securities Available for Sale:						
Obligations of U.S. government corporations and agencies	$ 10,287	$ (357)			$ 10,287	$ (357)
Obligations of states and political subdivisions	199	(1)			199	(1)
Corporate debt securities						
Total securities available-for-sale	$ 10,486	$ (358)			$ 10,486	$ (358)
Securities Held to Maturity:						
Obligations of U.S. government corporations and agencies	$ 188,218	$ (5,540)			$ 188,218	$ (5,540)
Obligations of states and political subdivisions	11,185	(1,455)			11,185	(1,455)
Corporate debt securities						
Total securities available-for-sale	$ 199,403	$ (6,995)			$ 199,403	$ (6,995)

At December 31, 2012, the Company had no investment securities with gross unrealized losses.

Obligations of U.S. government corporations and agencies: Unrealized losses on investments in obligations of U.S. government corporations and agencies are caused by interest rate increases. The contractual cash flows of these securities are guaranteed by U.S. Government Sponsored Entities (principally Fannie Mae and Freddie Mac). It is expected that the securities would not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell and more likely than not will not be required to sell, these investments are not considered other-than-temporarily impaired. At December 31, 2013, 31 debt securities representing obligations of U.S. government corporations and agencies had unrealized losses with aggregate depreciation of 2.89% from the Company s amortized cost basis.

Obligations of states and political subdivisions: The unrealized losses on investments in obligations of states and political subdivisions were caused by increases in required yields by investors in these types of securities. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell and more likely than not will not be required to sell, these investments are not considered other-than-temporarily impaired. At December 31, 2013, 14 debt securities representing obligations of states and political subdivisions had unrealized losses with aggregate depreciation of 11.34% from the Company s amortized cost basis.

Corporate debt securities: At December 31, 2013, no corporate debt securities had unrealized losses.

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Note 4 Loans

A summary of loan balances follows (in thousands):

	December 31, 2013				
	Originated	PNCI	PCI - Cash basis	PCI - Other	Total
Mortgage loans on real estate:					
Residential 1-4 family	$ 129,882	$ 60,475		$ 4,656	$ 195,013
Commercial	824,912	57,678		30,260	912,850
Total mortgage loan on real estate	954,794	118,153		34,916	1,107,863
Consumer:					
Home equity lines of credit	316,207	13,576	$ 6,200	3,883	339,866
Home equity loans	13,849	253		486	14,588
Auto Indirect	946				946
Other	25,608	2,074		81	27,763
Total consumer loans	356,610	15,903	6,200	4,450	383,163
Commercial	124,650	693	19	6,516	131,878
Construction:					
Residential	30,367			1,566	31,933
Commercial	17,125			45	17,170
Total construction	47,492			1,611	49,103
Total loans, net of deferred loan fees and discounts	$ 1,483,546	$ 134,749	$ 6,219	$ 47,493	$ 1,672,007
Total principal balance of loans owed, net of charge-offs	$ 1,487,240	$ 142,786	$ 16,475	$ 56,879	$ 1,703,380
Unamortized net deferred loan fees	(3,694)				(3,694)
Discounts to principal balance of loans owed, net of charge-offs		(8,037)	(10,256)	(9,386)	(27,679)
Total loans, net of unamortized deferred loan fees and discounts	$ 1,483,546	$ 134,749	$ 6,219	$ 47,493	$ 1,672,007
Noncovered loans	$ 1,483,546	$ 134,749	$ 6,219	$ 19,581	$ 1,644,095
Covered loans				27,912	27,912
Total loans, net of unamortized deferred loan fees and discounts	$ 1,483,546	$ 134,749	$ 6,219	$ 47,493	$ 1,672,007
Allowance for loan losses	$ (31,354)	$ (2,850)	$ (385)	$ (3,656)	$ (38,245)

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A summary of loan balances follows (in thousands):

	December 31, 2012				
	Originated	PNCI	PCI - Cash basis	PCI - Other	Total
Mortgage loans on real estate:					
Residential 1-4 family	$ 121,255	$ 5,413		$ 5,016	$ 131,684
Commercial	775,124	72,090	$ 1,289	29,943	878,446
Total mortgage loan on real estate	896,379	77,503	1,289	34,959	1,010,130
Consumer:					
Home equity lines of credit	311,671	16,788	7,612	5,954	342,025
Home equity loans	13,011	342	49	155	13,557
Auto Indirect	3,816				3,816
Other	24,263	2,418		32	26,713
Total consumer loans	352,761	19,548	7,661	6,141	386,111
Commercial	125,122	869	22	9,515	135,528
Construction:					
Residential	11,877			6,582	18,459
Commercial	11,196			3,399	14,595
Total construction	23,073			9,981	33,054
Total loans, net of deferred loan fees and discounts	$ 1,397,335	$ 97,920	$ 8,972	$ 60,596	$ 1,564,823
Total principal balance of loans owed, net of charge-offs	$ 1,400,147	$ 111,286	$ 20,621	$ 75,277	$ 1,607,331
Unamortized net deferred loan fees	(2,812)				(2,812)
Discounts to principal balance of loans owed, net of charge-offs		(13,366)	(11,649)	(14,681)	(39,696)
Total loans, net of unamortized deferred loan fees and discounts	$ 1,397,335	$ 97,920	$ 8,972	$ 60,596	$ 1,564,823
Noncovered loans	$ 1,397,335	$ 97,920	$ 8,972	$ 18,708	$ 1,522,935
Covered loans				41,888	41,888
Total loans, net of unamortized deferred loan fees and discounts	$ 1,397,335	$ 97,920	$ 8,972	$ 60,596	$ 1,564,823
Allowance for loan losses	$ (35,769)	$ (1,969)	$ (1,054)	$ (3,856)	$ (42,648)

The following is a summary of the change in accretable yield for PCI other loans during the periods indicated (in thousands):

	Year ended December 31, 2013	2012
Change in accretable yield:		
Balance at beginning of period	$ 22,337	$ 25,145
Acquisitions		
Accretion to interest income	(6,305)	(7,756)
Reclassification (to) from nonaccretable difference	2,201	4,948
Balance at end of period	$ 18,232	$ 22,337

Note 4 Loans (continued)

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Note 5 Allowance for Loan Losses

The following tables summarize the activity in the allowance for loan losses, and ending balance of loans, net of unearned fees for the periods indicated.

Allowance for Loan Losses Year Ended December 31, 2013

(in thousands)	RE Mortgage Resid.	RE Mortgage Comm.	Home Equity Lines	Home Equity Loans	Auto Indirect	Other Consum.	C&I	Construction Resid.	Construction Comm.	Total
Beginning balance	$ 3,523	$ 8,782	$ 21,367	$ 1,155	$ 243	$ 696	$ 4,703	$ 1,400	$ 779	$ 42,648
Charge-offs	(46)	(2,038)	(2,651)	(94)	(68)	(887)	(1,599)	(20)	(140)	(7,543)
Recoveries	345	994	1,053	41	195	759	340	63	65	3,855
(Benefit) provision	(668)	1,962	(3,394)	106	(304)	21	887	116	559	(715)
Ending balance	$ 3,154	$ 9,700	$ 16,375	$ 1,208	$ 66	$ 589	$ 4,331	$ 1,559	$ 1,263	$ 38,245
Ending balance:										
Individ. evaluated for impairment	$ 775	$ 1,198	$ 1,140	$ 169	$ 1	$ 8	$ 585	$ 91	$ 8	$ 3,975
Loans pooled for evaluation	$ 2,039	$ 7,815	$ 14,749	$ 1,039	$ 65	$ 581	$ 2,402	$ 751	$ 789	$ 30,230
Loans acquired with deteriorated credit quality	$ 340	$ 687	$ 486				$ 1,344	$ 717	$ 466	$ 4,040

Loans, net of unearned fees As of December 31, 2013

(in thousands)	RE Mortgage Resid.	RE Mortgage Comm.	Home Equity Lines	Home Equity Loans	Auto Indirect	Other Consum.	C&I	Construction Resid.	Construction Comm.	Total
Ending balance:										
Total loans	$ 195,013	$ 912,850	$ 339,866	$ 14,588	$ 946	$ 27,763	$ 131,878	$ 31,933	$ 17,170	$ 1,672,007

Individ. evaluated for impairment	$ 7,342	$ 59,936	$ 6,918	$ 778	$ 60	$ 90	$ 3,177	$ 2,756	$ 178	$ 81,235
Loans pooled for evaluation	$ 183,015	$ 822,654	$ 322,865	$ 13,324	$ 886	$ 27,592	$ 122,166	$ 27,611	$ 16,947	$ 1,537,060
Loans acquired with deteriorated credit quality	$ 4,656	$ 30,260	$ 10,083	$ 486		$ 81	$ 6,535	$ 1,566	$ 45	$ 53,712

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Note 5 Allowance for Loan Losses (continued)

Allowance for Loan Losses Year Ended December 31, 2012

(in thousands)	RE Mortgage Resid.	RE Mortgage Comm.	Home Equity Lines	Home Equity Loans	Auto Indirect	Other Consum.	C&I	Construction Resid.	Construction Comm.	Total
Beginning balance	$ 2,404	$ 13,217	$ 18,258	$ 1,101	$ 215	$ 932	$ 6,545	$ 1,817	$ 1,425	$ 45,914
Charge-offs	(1,558)	(3,457)	(8,042)	(385)	(83)	(1,202)	(1,251)	(406)	(100)	(16,484)
Recoveries	147	1,020	398	100	215	860	643	412		3,795
Provision (benefit)	2,530	(1,998)	10,753	339	(104)	106	(1,234)	(423)	(546)	9,423
Ending balance	$ 3,523	$ 8,782	$ 21,367	$ 1,155	$ 243	$ 696	$ 4,703	$ 1,400	$ 779	$ 42,648
Ending balance:										
Individ. evaluated for impairment	$ 631	$ 515	$ 2,264	$ 81	$ 5	$ 47	$ 840	$ 11	$ 111	$ 4,505
Loans pooled for evaluation	$ 2,526	$ 8,026	$ 17,862	$ 995	$ 238	$ 649	$ 2,342	$ 430	$ 165	$ 33,233
Loans acquired with deteriorated credit quality	$ 366	$ 241	$ 1,241	$ 79			$ 1,521	$ 959	$ 503	$ 4,910

Loans, net of unearned fees As of December 31, 2012

(in thousands)	RE Mortgage Resid.	RE Mortgage Comm.	Home Equity Lines	Home Equity Loans	Auto Indirect	Other Consum.	C&I	Construction Resid.	Construction Comm.	Total
Ending balance:										
Total loans	$ 131,684	$ 878,446	$ 342,025	$ 13,557	$ 3,816	$ 26,713	$ 135,528	$ 18,459	$ 14,595	$ 1,564,823
	$ 6,586	$ 71,077	$ 10,056	$ 528	$ 197	$ 121	$ 8,562	$ 3,596	$ 607	$ 101,330

Individ. evaluated for impairment										
Loans pooled for evaluation	$ 120,082	$ 776,137	$ 318,403	$ 12,825	$ 3,619	$ 26,560	$ 117,429	$ 8,281	$ 10,589	$ 1,393,925
Loans acquired with deteriorated credit quality	$ 5,016	$ 31,232	$ 13,566	$ 204		$ 32	$ 9,537	$ 6,582	$ 3,399	$ 69,568

	Allowance for Loan Losses	Year Ended December 31, 2011								
	RE Mortgage		Home Equity					Construction		
(in thousands)	Resid.	Comm.	Lines	Loans	Auto Indirect	Other Consum.	C&I	Resid.	Comm.	Total
Beginning balance	$ 3,007	$ 12,700	$ 15,054	$ 795	$ 1,229	$ 701	$ 5,991	$ 1,824	$ 1,270	$ 42,571
Charge-offs	(1,655)	(4,451)	(9,746)	(789)	(427)	(1,158)	(2,534)	(634)	(653)	(22,047)
Recoveries	126	127	573	45	379	839	173	28	40	2,330
Provision (benefit)	926	4,841	12,377	1,050	(966)	550	2,915	599	768	23,060
Ending balance	$ 2,404	$ 13,217	$ 18,258	$ 1,101	$ 215	$ 932	$ 6,545	$ 1,817	$ 1,425	$ 45,914
Ending balance:										
Individ. evaluated for impairment	$ 460	$ 1,620	$ 2,365	$ 73	$ 29	$ 24	$ 193	$ 258	$ 971	$ 5,993
Loans pooled for evaluation	$ 1,750	$ 11,374	$ 14,531	$ 978	$ 186	$ 892	$ 4,618	$ 1,324	$ 57	$ 35,710
Loans acquired with deteriorated credit quality	$ 194	$ 223	$ 1,362	$ 50		$ 16	$ 1,734	$ 235	$ 397	$ 4,211

(in thousands)	RE Mortgage Resid.	RE Mortgage Comm.	Home Equity Lines	Home Equity Loans	Auto Indirect	Other Consum.	C&I	Construction Resid.	Construction Comm.	Total
Loans, net of unearned fees As of December 31, 2011										
Ending balance:										
Total loans	$ 139,586	$ 826,336	$ 357,305	$ 14,844	$ 10,821	$ 23,360	$ 139,131	$ 22,122	$ 17,527	$ 1,551,032
Individ. evaluated for impairment	$ 10,167	$ 71,893	$ 9,388	$ 661	$ 571	$ 109	$ 9,526	$ 5,627	$ 6,899	$ 114,841
Loans pooled for evaluation	$ 122,903	$ 721,217	$ 333,348	$ 14,026	$ 10,250	$ 23,202	$ 115,765	$ 8,281	$ 5,845	$ 1,354,837
Loans acquired with deteriorated credit quality	$ 6,516	$ 33,226	$ 14,569	$ 157		$ 49	$ 13,840	$ 8,214	$ 4,783	$ 81,354

As part of the on-going monitoring of the credit quality of the Company s loan portfolio, management tracks certain credit quality indicators including, but not limited to, trends relating to (i) the level of criticized and classified loans, (ii) net charge-offs, (iii) non-performing loans, and (iv) delinquency within the portfolio.

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The Company utilizes a risk grading system to assign a risk grade to each of its loans. Loans are graded on a scale ranging from Pass to Loss. A description of the general characteristics of the risk grades is as follows:

Pass This grade represents loans ranging from acceptable to very little or no credit risk. These loans typically meet most if not all policy standards in regard to: loan amount as a percentage of collateral value, debt service coverage, profitability, leverage, and working capital.

Special Mention This grade represents Other Assets Especially Mentioned in accordance with regulatory guidelines and includes loans that display some potential weaknesses which, if left unaddressed, may result in deterioration of the repayment prospects for the asset or may inadequately protect the Company s position in the future. These loans warrant more than normal supervision and attention.

Substandard This grade represents Substandard loans in accordance with regulatory guidelines. Loans within this rating typically exhibit weaknesses that are well defined to the point that repayment is jeopardized. Loss potential is, however, not necessarily evident. The underlying collateral supporting the credit appears to have sufficient value to protect the Company from loss of principal and accrued interest, or the loan has been written down to the point where this is true. There is a definite need for a well defined workout/rehabilitation program.

Doubtful This grade represents Doubtful loans in accordance with regulatory guidelines. An asset classified as Doubtful has all the weaknesses inherent in a loan classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral, and financing plans.

Loss This grade represents Loss loans in accordance with regulatory guidelines. A loan classified as Loss is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off the loan, even though some recovery may be affected in the future. The portion of the loan that is graded loss should be charged off no later than the end of the quarter in which the loss is identified.

The following tables present ending loan balances by loan category and risk grade for the periods indicated:

Credit Quality Indicators As of December 31, 2013

	RE Mortgage		Home Equity					Construction		
(in thousands)	Resid.	Comm.	Lines	Loans	Auto Indirect	Other Consum.	C&I	Resid.	Comm.	Total
Originated loans:										
Pass	$ 121,969	$ 768,596	$ 203,232	$ 12,284	$ 717	$ 24,653	$ 121,580	$ 25,836	$ 16,571	$ 1,394,438

Special mention	1,265	15,862	4,529	504	118	756	938	96	343	24,411
Substandard	6,648	40,454	9,446	1,061	111	196	2,122	4,435	211	64,684
Loss						3	10			13
Total originated	$ 129,882	$ 824,912	$ 316,207	$ 13,849	$ 946	$ 25,608	$ 124,650	$ 30,367	$ 17,125	$ 1,483,546
PNCI loans:										
Pass	$ 59,798	$ 48,548	$ 12,716	$ 253		$ 2,020	$ 380			$ 123,715
Special mention		5,810	195			18	313			6,336
Substandard	677	3,320	665			36				4,698
Loss										
Total PNCI	$ 60,475	$ 57,678	$ 13,576	$ 253		$ 2,074	$ 693			$ 134,749
PCI loans	$ 4,656	$ 30,260	$ 10,083	$ 486		$ 81	$ 6,535	$ 1,566	$ 45	$ 53,712
Total loans	$ 195,013	$ 912,850	$ 339,866	$ 14,588	$ 946	$ 27,763	$ 131,878	$ 31,933	$ 17,170	$ 1,672,007

Credit Quality Indicators As of December 31, 2012

	RE Mortgage		Home Equity					Construction		
(in thousands)	Resid.	Comm.	Lines	Loans	Auto Indirect	Other Consum.	C&I	Resid.	Comm.	Total
Originated loans:										
Pass	$ 108,946	$ 686,593	$ 291,701	$ 11,892	$ 2,949	$ 23,154	$ 113,595	$ 7,744	$ 10,221	$ 1,256,795
Special mention	3,122	21,184	6,955	555	531	958	3,224	285	356	37,170
Substandard	9,187	67,347	13,015	564	336	151	8,303	3,848	619	103,370
Total originated	$ 121,255	$ 775,124	$ 311,671	$ 13,011	$ 3,816	$ 24,263	$ 125,122	$ 11,877	$ 11,196	$ 1,397,335
PNCI loans:										
Pass	$ 4,968	$ 64,917	$ 15,915	$ 342		$ 2,240	$ 848			$ 89,230
Special mention		5,249	193			104	21			5,567
Substandard	436	1,924	680			74				3,114
Loss	9									9
Total PNCI	$ 5,413	$ 72,090	$ 16,788	$ 342		$ 2,418	$ 869			$ 97,920
PCI loans	$ 5,016	$ 31,232	$ 13,566	$ 204		$ 32	$ 9,537	$ 6,582	$ 3,399	$ 69,568
Total loans	$ 131,684	$ 878,446	$ 342,025	$ 13,557	$ 3,816	$ 26,713	$ 135,528	$ 18,459	$ 14,595	$ 1,564,823

Consumer loans, whether unsecured or secured by real estate, automobiles, or other personal property, are susceptible to three primary risks; non-payment due to income loss, over-extension of credit and, when the borrower is unable to pay, shortfall in collateral value. Typically non-payment is due to loss of job and will follow general economic trends in the marketplace driven primarily by rises in the unemployment rate. Loss of collateral value can be due to market demand shifts, damage to collateral itself or a combination of the two.

Problem consumer loans are generally identified by payment history of the borrower (delinquency). The Bank manages its consumer loan portfolios by monitoring delinquency and contacting borrowers to encourage repayment, suggest modifications if appropriate, and, when continued scheduled payments become unrealistic, initiate repossession or foreclosure through appropriate channels. Collateral values may be determined by appraisals obtained through Bank approved, licensed appraisers, qualified independent third parties, public value information (blue book values for autos), sales invoices, or other appropriate means. Appropriate valuations are obtained at initiation of the credit and periodically (every 3-12 months depending on collateral type) once repayment is questionable and the loan has been classified.

Commercial real estate loans generally fall into two categories, owner-occupied and non-owner occupied. Loans secured by owner occupied real estate are primarily susceptible to changes in the business conditions of the related business. This may be driven by, among other things, industry changes, geographic business changes, changes in the individual fortunes of the business owner, and general economic conditions and changes in business cycles. These same risks apply to commercial loans whether secured by equipment or other personal property or unsecured. Losses on loans secured by owner occupied real estate, equipment, or other personal property generally are dictated by the value of underlying collateral at the time of default and liquidation of the collateral. When default is driven by issues related specifically to the business owner, collateral values tend to provide better repayment support and may result in little or no loss. Alternatively, when default is driven by more general economic conditions, underlying collateral generally has devalued more and results in larger losses due to default. Loans secured by non-owner occupied real estate are primarily susceptible to risks associated with swings in occupancy or vacancy and related shifts in lease rates, rental rates or room rates. Most often these shifts are a result of changes in general economic or market conditions or overbuilding and resultant over-supply. Losses are dependent on value of underlying collateral at the time of default. Values are generally driven by these same factors and influenced by interest rates and required rates of return as well as changes in occupancy costs.

Construction loans, whether owner occupied or non-owner occupied commercial real estate loans or residential development loans, are not only susceptible to the related risks described above but the added risks of construction itself including cost over-runs, mismanagement of the project, or lack of demand or market changes experienced at time of completion. Again, losses are primarily related to underlying collateral value and changes therein as described above.

Problem C&I loans are generally identified by periodic review of financial information which may include financial statements, tax returns, rent rolls and payment history of the borrower (delinquency). Based on this information the Bank may decide to take any of several courses of action including demand for repayment, additional collateral or guarantors, and, when repayment becomes unlikely through borrower s income and cash flow, repossession or foreclosure of the underlying collateral.

Collateral values may be determined by appraisals obtained through Bank approved, licensed appraisers, qualified independent third parties, public value information (blue book values for autos), sales invoices, or other appropriate means. Appropriate valuations are obtained at initiation of the credit and periodically (every 3-12 months depending on collateral type) once repayment is questionable and the loan has been classified.

Once a loan becomes delinquent and repayment becomes questionable, a Bank collection officer will address collateral shortfalls with the borrower and attempt to obtain additional collateral. If this is not forthcoming and payment in full is unlikely, the Bank will estimate its probable loss, using a recent valuation as appropriate to the underlying collateral less estimated costs of sale, and charge the loan down to the estimated net realizable amount. Depending on the length of time until ultimate collection, the Bank may revalue the underlying collateral and take additional charge-offs as warranted. Revaluations may occur as often as every 3-12 months depending on the underlying collateral and volatility of values. Final charge-offs or recoveries are taken when collateral is liquidated and actual loss is known. Unpaid balances on loans after or during collection and liquidation may also be pursued through lawsuit and attachment of wages or judgment liens on borrower s other assets.

The following table shows the ending balance of current, past due, and nonaccrual originated loans by loan category as of the date indicated:

Analysis of Past Due and Nonaccrual Originated Loans As of December 31, 2013

	RE Mortgage		Home Equity					Construction		
(in thousands)	Resid.	Comm.	Lines	Loans	Auto Indirect	Other Consum.	C&I	Resid.	Comm.	Total
Originated loan balance:										
Past due:										
30-59 Days	$ 2,272	$ 2,304	$ 3,121	$ 264	$ 24	$ 40	$ 296			$ 8,321
60-89 Days	284		1,070	16	1	16	76		$ 198	1,661
> 90 Days	447	2,213	1,050	312	33	7	749	13		4,824
Total past due	$ 3,003	$ 4,517	$ 5,241	$ 592	$ 58	$ 63	$ 1,121	$ 13	$ 198	$ 14,806
Current	126,879	820,395	310,966	13,257	888	25,545	123,529	30,354	16,927	1,468,740
Total orig. loans	$ 129,882	$ 824,912	$ 316,207	$ 13,849	$ 946	25,608	$ 124,650	$ 30,367	$ 17,125	$ 1,483,546
> 90 Days and still accruing										
Nonaccrual loans	$ 4,697	$ 30,732	$ 4,972	$ 719	$ 54	$ 26	$ 1,280	$ 2,473	$ 178	$ 45,131

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The following table shows the ending balance of current, past due, and nonaccrual PNCI loans by loan category as of the date indicated:

Analysis of Past Due and Nonaccrual PNCI Loans As of December 31, 2013

	RE Mortgage		Home Equity		Auto	Other		Construction		
(in thousands)	Resid.	Comm.	Lines	Loans	Indirect	Consum.	C&I	Resid.	Comm.	Total
PNCI loan balance:										
Past due:										
30-59 Days	$ 799	$ 512	$ 313			$ 49				$ 1,673
60-89 Days		352	38							390
> 90 Days		217								217
Total past due	$ 799	$ 1,081	$ 351			$ 49				$ 2,280
Current	59,676	56,597	13,225	$ 253		2,025	$ 693			132,469
Total PNCI loans	$ 60,475	$ 57,678	$ 13,576	$ 253		$ 2,074	$ 693			$ 134,749
> 90 Days and still accruing										
Nonaccrual loans	$ 262	$ 1,139	$ 429			$ 36				$ 1,866

The following table shows the ending balance of current, past due, and nonaccrual originated loans by loan category as of the date indicated:

Analysis of Past Due and Nonaccrual Originated Loans As of December 31, 2012

	RE Mortgage		Home Equity					Construction		
(in thousands)	Resid.	Comm.	Lines	Loans	Auto Indirect	Other Consum.	C&I	Resid.	Comm.	Total
Originated loan balance:										
Past due:										
30-59 Days	$ 1,702	$ 2,695	$ 3,371	$ 67	$ 77	$ 67	$ 1,848	$ 309		$ 10,136
60-89 Days	278	1,578	819	33	40	40	138			2,926
> 90 Days	674	13,829	3,395	217	79	14	4,782	42	$ 94	23,126
Total past due	$ 2,654	$ 18,102	$ 7,585	$ 317	$ 196	$ 121	$ 6,768	$ 351	$ 94	$ 36,188
Current	118,601	757,022	304,086	12,694	3,620	24,142	118,354	11,526	11,102	1,361,147
Total orig. loans	$ 121,255	$ 775,124	$ 311,671	$ 13,011	$ 3,816	$ 24,263	$ 125,122	$ 11,877	$ 11,196	$ 1,397,335

> 90 Days and still accruing										
Nonaccrual loans	$ 4,781	$ 37,220	$ 8,486	$ 465	$ 174	$ 49	$ 6,750	$ 3,312	$ 532	$ 61,769

The following table shows the ending balance of current, past due, and nonaccrual PNCI loans by loan category as of the date indicated:

	Analysis of Past Due and Nonaccrual PNCI Loans						As of December 31, 2012			
	RE Mortgage		Home Equity		Auto	Other		Construction		
(in thousands)	Resid.	Comm.	Lines	Loans	Indirect	Consum.	C&I	Resid.	Comm.	Total
PNCI loan balance:										
Past due:										
30-59 Days	$ 1,024	$ 500	$ 124			$ 31				$ 1,679
60-89 Days			63							63
> 90 Days	43	148	157							348
Total past due	$ 1,067	$ 648	$ 344			$ 31				$ 2,090
Current	4,346	71,442	16,444	$ 342		2,387	$ 869			95,830
Total PNCI loans	$ 5,413	$ 72,090	$ 16,788	$ 342		$ 2,418	$ 869			$ 97,920
> 90 Days and still accruing										
Nonaccrual loans	$ 113	$ 1,218	$ 403			$ 42				$ 1,776

Impaired originated loans are those where management has concluded that it is probable that the borrower will be unable to pay all amounts due under the contractual terms. The following tables show the recorded investment (financial statement balance), unpaid principal balance, average recorded investment, and interest income recognized for impaired Originated and PNCI loans, segregated by those with no related allowance recorded and those with an allowance recorded for the periods indicated.

	Impaired Originated Loans As of December 31, 2013									
	RE Mortgage		Home Equity					Construction		
(in thousands)	Resid.	Comm.	Lines	Loans	Auto Indirect	Other Consum.	C&I	Resid.	Comm.	Total
With no related allowance recorded:										
Recorded investment	$ 4,366	$ 53,352	$ 3,710	$ 552	$ 55	$ 16	$ 1,648	$ 2,473	$ 69	$ 66,241
Unpaid principal	$ 6,489	$ 58,894	$ 7,299	$ 1,249	$ 123	$ 21	$ 1,665	$ 6,611	$ 138	$ 82,489
Average recorded Investment	$ 4,123	$ 58,205	$ 4,410	$ 463	$ 93	$ 18	$ 2,154	$ 1,567	$ 83	$ 71,116
Interest income Recognized	$ 336	$ 3,361	$ 352	$ 36	$ 12	$ 1	$ 113	$ 108	$ 7	$ 4,326
With an allowance recorded:										
Recorded investment	$ 2,630	$ 5,296	$ 2,779	$ 226	$ 4	$ 10	$ 1,517	$ 284	$ 109	$ 12,855
Unpaid principal	$ 2,689	$ 5,659	$ 3,053	$ 291	$ 6	$ 10	$ 1,616	$ 284	$ 288	$ 13,896
Related allowance	$ 648	$ 1,084	$ 968	$ 169	$ 1	$ 5	$ 585	$ 91	$ 7	$ 3,558
Average recorded Investment	$ 2,245	$ 6,077	$ 3,064	$ 141	$ 12	$ 7	$ 1,817	$ 1,499	$ 188	$ 15,050
Interest income	$ 124	$ 287	$ 146	$ 18	$ 1	$ 2	$ 95	$ 19	$ 15	$ 707

Recognized

	Impaired PNCI Loans	As of December 31, 2013								
	RE Mortgage		Home Equity					Construction		
(in thousands)	Resid.	Comm.	Lines	Loans	Auto Indirect	Other Consum.	C&I	Resid.	Comm.	Total
With no related allowance recorded:										
Recorded investment	$ 148	$ 1,139	$ 227			$ 36	$ 12			$ 1,562
Unpaid principal	$ 158	$ 3,323	$ 287			$ 45	$ 12			$ 3,825
Average recorded Investment	$ 37	$ 1,005	$ 333							