

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

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

for the quarterly period ended: **September 30, 2017**

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

for the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number: **000-10661**

**TriCo Bancshares**

(Exact Name of Registrant as Specified in Its Charter)

**CALIFORNIA**  
(State or Other Jurisdiction  
of Incorporation or Organization)

**94-2792841**  
(I.R.S. Employer  
Identification Number)

**63 Constitution Drive**  
**Chico, California 95973**  
(Address of Principal Executive Offices)(Zip Code)

**(530) 898-0300**  
(Registrant's Telephone Number, Including Area Code)

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

Yes  No

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

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company  
 Emerging growth company

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

Yes  No

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

Common stock, no par value: 22,941,464 shares outstanding as of November 7, 2017

TriCo Bancshares  
FORM 10-Q  
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**FORWARD-LOOKING STATEMENTS**

This report on Form 10-Q contains forward-looking statements about TriCo Bancshares (the “Company”) that are subject to the protection of the safe harbor provisions contained in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on the current knowledge and belief of the Company’s management (“Management”) 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, it may mean the Company is 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. The reader is directed to the Company’s annual report on Form 10-K for the year ended December 31, 2016 and Part II, Item 1A of this report for further discussion of factors which could affect the Company’s business and cause actual results to differ materially from those suggested by any forward-looking statement made in this report. Such Form 10-K and this report should be read in their entirety to put any forward-looking statements in context and to gain a more complete understanding of the risks and uncertainties involved in the Company’s business. Any forward-looking statement may turn out to be wrong and cannot be guaranteed. The Company does not intend to update any forward-looking statement after the date of this report.

**PART I – FINANCIAL INFORMATION**

**Item 1. Financial Statements (unaudited)**

**TRICO BANCSHARES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share data; unaudited)

	At September 30, 2017	At December 31, 2016
Assets:		
Cash and due from banks	\$86,815	\$92,197
Cash at Federal Reserve and other banks	101,219	213,415
	<hr/>	<hr/>
Cash and cash equivalents	188,034	305,612
Investment securities:		
Available for sale	678,236	550,233
Held to maturity	536,567	602,536
Restricted equity securities	16,956	16,956
Loans held for sale	2,733	2,998
Loans	2,931,613	2,759,593
Allowance for loan losses	(28,747)	(32,503)
Total loans, net	2,902,866	2,727,090
Foreclosed assets, net	3,071	3,986
Premises and equipment, net	54,995	48,406
Cash value of life insurance	97,142	95,912
Accrued interest receivable	12,656	12,027
Goodwill	64,311	64,311
Other intangible assets, net	5,513	6,563
Mortgage servicing rights	6,419	6,595
Other assets	86,936	74,743
	<hr/>	<hr/>
Total assets	\$4,656,435	\$4,517,968
	<hr/> <hr/>	<hr/> <hr/>
Liabilities and Shareholders' Equity:		
Liabilities:		
Deposits:		
Noninterest-bearing demand	\$1,283,949	\$1,275,745
Interest-bearing	2,643,507	2,619,815
	<hr/>	<hr/>
Total deposits	3,927,456	3,895,560
Accrued interest payable	867	818
Reserve for unfunded commitments	2,989	2,719
Other liabilities	62,850	67,364
Other borrowings	98,730	17,493
Junior subordinated debt	56,810	56,667
	<hr/>	<hr/>
Total liabilities	4,149,702	4,040,621
	<hr/>	<hr/>
Commitments and contingencies (Note 18)		
Shareholders' equity:		
Common stock, no par value: 50,000,000 shares authorized; issued and outstanding:		
22,941,464 at September 30, 2017	255,231	
22,867,802 at December 31, 2016		252,820
Retained earnings	256,114	232,440
Accumulated other comprehensive loss, net of tax	(4,612)	(7,913)
	<hr/>	<hr/>
Total shareholders' equity	506,733	477,347
	<hr/>	<hr/>
Total liabilities and shareholders' equity	\$4,656,435	\$4,517,968
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The accompanying notes are an integral part of these consolidated financial statements.

**TRICO BANCSHARES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
(In thousands, except per share data; unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Interest and dividend income:				
Loans, including fees	\$37,268	\$35,769	\$108,600	\$104,845
Investment securities:				
Taxable	7,011	6,297	20,617	19,377
Tax exempt	1,041	978	3,124	2,850
Dividends	301	390	1,020	1,175
Interest bearing cash at Federal Reserve and other banks	292	275	1,080	846
<b>Total interest and dividend income</b>	<b>45,913</b>	<b>43,709</b>	<b>134,441</b>	<b>129,093</b>
Interest expense:				
Deposits	1,028	875	2,896	2,611
Other borrowings	149	2	164	7
Junior subordinated debt	652	562	1,870	1,643
<b>Total interest expense</b>	<b>1,829</b>	<b>1,439</b>	<b>4,930</b>	<b>4,261</b>
Net interest income	44,084	42,270	129,511	124,832
Provision (Reversal of provision) for loan losses	765	(3,973)	(1,588)	(4,537)
Net interest income after reversal of provision loan losses	43,319	46,243	131,099	129,369
Noninterest income:				
Service charges and fees	9,475	8,022	27,861	23,426
Gain on sale of loans	606	953	2,293	2,645
Commissions on sale of non-deposit investment products	672	747	1,984	1,890
Increase in cash value of life insurance	732	709	2,043	2,086
Gain on sale of investments securities	961	-	961	-
Other	484	635	2,401	2,054
<b>Total noninterest income</b>	<b>12,930</b>	<b>11,066</b>	<b>37,543</b>	<b>32,101</b>
Noninterest expense:				
Salaries and related benefits	20,933	20,860	62,320	60,170
Other	16,289	16,556	46,628	49,264
<b>Total noninterest expense</b>	<b>37,222</b>	<b>37,416</b>	<b>108,948</b>	<b>109,434</b>
Income before income taxes	19,027	19,893	59,694	52,036
Provision for income taxes	7,130	7,694	22,129	19,758
<b>Net income</b>	<b>\$11,897</b>	<b>\$12,199</b>	<b>\$37,565</b>	<b>\$32,278</b>
Earnings per share:				
Basic	\$0.52	\$0.53	\$1.64	\$1.42
Diluted	\$0.51	\$0.53	\$1.62	\$1.40

See accompanying notes to unaudited condensed consolidated financial statements.

**TRICO BANCSHARES**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(In thousands; unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Net income	\$11,897	\$12,199	\$37,565	\$32,278
Other comprehensive (loss) income, net of tax:				
Unrealized (losses) gains on available for sale securities arising during the period	(166)	(1,193)	3,137	6,514
Change in minimum pension liability	55	74	164	222
Change in joint beneficiary agreement liability	-	(1)	-	(5)
Other comprehensive (loss) income	(111)	(1,120)	3,301	6,731
Comprehensive income	<u>\$11,786</u>	<u>\$11,079</u>	<u>\$40,866</u>	<u>\$39,009</u>

See accompanying notes to unaudited condensed consolidated financial statements.

**TRICO BANCSHARES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
(In thousands, except share and per share data; unaudited)

	Shares of Common Stock	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (loss)	Total
Balance at December 31, 2015	22,775,173	\$247,587	\$206,307	\$(1,778)	\$452,116
Net income			32,278		32,278
Other comprehensive income				6,731	6,731
Stock option vesting		455			455
RSU vesting		440			440
PSU vesting		183			183
Stock options exercised	132,700	2,908			2,908
RSUs released	20,529				
Tax effect of stock option exercise		(183)			(183)
Tax effect of RSU release		1			1
Repurchase of common stock	(101,125)	(1,101)	(1,673)		(2,774)
Dividends paid (\$0.45 per share)			(10,265)		(10,265)
Balance at September 30, 2016	<u>22,827,277</u>	<u>\$250,290</u>	<u>\$226,647</u>	<u>\$4,953</u>	<u>\$481,890</u>
Balance at December 31, 2016	22,867,802	\$252,820	\$232,440	\$(7,913)	\$477,347
Net income			37,565		37,565
Other comprehensive income				3,301	3,301
Stock option vesting		211			211
RSU vesting		657			657
PSU vesting		316			316
Stock options exercised	133,850	2,418			2,418
RSUs released	28,397				
PSUs released	18,805				
Repurchase of common stock	(107,390)	(1,191)	(2,663)		(3,854)
Dividends paid (\$0.49 per share)			(11,228)		(11,228)
Balance at September 30, 2017	<u>22,941,464</u>	<u>\$255,231</u>	<u>\$256,114</u>	<u>\$(4,612)</u>	<u>\$506,733</u>

See accompanying notes to unaudited condensed consolidated financial statements.

**TRICO BANCSHARES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands; unaudited)

	For the nine months ended September 30,	
	2017	2016
Operating activities:		
Net income	\$37,565	\$32,278
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of premises and equipment, and amortization	5,089	4,870
Amortization of intangible assets	1,050	1,017
Benefit from reversal of provision for loan losses	(1,588)	(4,537)
Amortization of investment securities premium, net	2,431	3,625
Gain on sale of investment securities	(961)	-
Originations of residential mortgage loans for resale	(83,907)	(101,206)
Proceeds from sale of residential mortgage loans originated for resale	85,846	97,056
Gain on sale of loans	(2,293)	(2,645)
Change in market value of mortgage servicing rights	795	2,198
Provision for losses on foreclosed assets	162	40
Gain on sale of foreclosed assets	(308)	(218)
Write down of fixed assets held for sale	-	716
Loss on disposal of fixed assets	61	52
Gain on sale of premises held for sale	(3)	-
Increase in cash value of life insurance	(2,043)	(2,086)
Life insurance proceeds in excess of cash value	(108)	(238)
Equity compensation vesting expense	1,184	1,078
Tax effect of equity compensation exercise or release	-	182
Change in:		
Reserve for unfunded commitments	270	433
Interest receivable	(629)	(33)
Interest payable	49	-
Other assets and liabilities, net	3,155	6,302
Net cash from operating activities	45,817	38,884
Investing activities:		
Proceeds from maturities of securities available for sale	46,646	47,722
Proceeds from maturities of securities held to maturity	64,969	83,665
Purchases of securities available for sale	(195,465)	(160,787)
Loan origination and principal collections, net	(174,914)	(198,366)
Loans purchased	-	(22,503)
Proceeds from sale of loans other than loans originated for sale	-	32,029
Proceeds from sale of other real estate owned	1,787	3,375
Proceeds from sale of premises and equipment	-	1,231
Proceeds from the sale of premises held for sale	3,338	-
Purchases of premises and equipment	(10,874)	(10,048)
Life insurance proceeds	649	-
Cash acquired in acquisition	-	156,316
Net cash used by investing activities	(263,864)	(67,366)
Financing activities:		
Net increase in deposits	31,896	43,515
Net change in other borrowings	81,237	6,907
Tax effect of equity compensation exercise or release	-	(182)
Repurchase of common stock	(1,629)	(384)
Dividends paid	(11,228)	(10,265)
Exercise of stock options	193	518
Net cash provided by financing activities	100,469	40,109
Net change in cash and cash equivalents	(117,578)	11,627
Cash and cash equivalents and beginning of year	305,612	303,461
Cash and cash equivalents at end of period	\$188,034	\$315,088
Supplemental disclosure of noncash activities:		
Unrealized gain (loss) on securities available for sale	\$5,411	\$11,240
Loans transferred to foreclosed assets	\$726	\$1,953
Fixed assets transferred to held for sale	-	\$1,934
Due from broker	\$25,757	-
Market value of shares tendered in-lieu of cash to pay for exercise of options, release of RSUs, and/or related taxes	\$3,854	\$2,774
Supplemental disclosure of cash flow activity:		
Cash paid for interest expense	\$4,881	\$4,261
Cash paid for income taxes	\$15,450	\$15,515
Assets acquired in acquisition	-	\$161,231
Liabilities assumed in acquisition	-	\$161,231

See accompanying notes to unaudited condensed consolidated financial statements.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

### Note 1 – Summary of Significant Accounting Policies

#### Description of Business and Basis of Presentation

TriCo Bancshares (the “Company” or “we”) is a California corporation organized to act as a bank holding company for Tri Counties Bank (the “Bank”). The Company and the Bank are headquartered in Chico, California. The Bank is a California-chartered bank that is engaged in the general commercial banking business in 26 California counties. The Bank operates from 57 traditional branches and 9 in-store branches. The Company has five capital subsidiary business trusts (collectively, the “Capital Trusts”) that issued trust preferred securities, including two organized by TriCo and three acquired with the acquisition of North Valley Bancorp. See Note 17 – Junior Subordinated Debt.

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 Capital Trusts of \$1,706,000 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 Capital 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. 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.

#### 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 three months ended September 30, 2017, the Company sold \$24,796,000 of available for sale classified investment securities for \$25,757,000 realizing a gain of \$961,000. During the six months ended June 30, 2017 and throughout 2016, the Company did not have any securities classified as trading.

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 more likely than not 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 nine months ended September 30, 2017 or the year ended December 31, 2016.

#### 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 Bank 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 Bank 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 incurred losses inherent in existing loans, based on evaluations of the collectability, impairment and prior loss experience of loans. 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 original 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 specific reserve allocation within the allowance for loan losses.

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 probable incurred 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 probable incurred 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, 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.

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, thereafter, the Company determines that the estimated future cash flows of a PCI loan are expected to be less than previously estimated, 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. The Company refers to PCI loans on nonaccrual status that are accounted for using the cash basis method of income recognition as "PCI – cash basis" loans; and the Company refers to all other PCI loans as "PCI – other" loans. 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, N.A. ("Granite") during 2010 and Citizens Bank of Northern California ("Citizens") during 2011.

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 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.

### **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. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Any write-downs based on the asset's fair value less costs to sell at the date of acquisition are charged to the allowance for loan and lease losses. Any recoveries based on the asset's fair value less estimated costs to sell in excess of the recorded value of the loan at the date of acquisition are recorded to the allowance for loan and lease losses. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed. 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 shorter of 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, 2016 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 and commercial 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.

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/Liability**

The Company accounts for amounts receivable or payable 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 or pay to 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.

### **Low Income Housing Tax Credits**

The Company accounts for low income housing tax credits and the related qualified affordable housing projects using the proportional amortization method. Under the proportional amortization method, the Company amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). Upon entering into a qualified affordable housing project, the Company records, in other liabilities, the entire amount that it has agreed to invest in the project, and an equal amount, in other assets, representing its investment in the project. As the Company disburses cash to satisfy its investment obligation, other liabilities are reduced. Over time, as the tax credits and other tax benefits of the project are realized by the Company, the investment recorded in other assets is reduced using the proportional amortization method.

### **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

During the three months ended September 30, 2017, the Company changed its classification of 1<sup>st</sup> lien and 2<sup>nd</sup> lien non-owner occupied 1-4 residential real estate mortgage loans from commercial real estate mortgage loans to residential real estate mortgage loans and consumer home equity loans, respectively. This change in loan category classification was made to better align the Company's financial reporting classifications with regulatory reporting classifications, and to properly classify these loans for regulatory risk-based capital ratio calculations. As a result of these reclassifications, at September 30, 2017, loans with balances of \$60,957,000, and \$5,620,000, that would have been classified as commercial real estate mortgage loans prior to this change, were classified as residential real estate mortgage loans, and consumer home equity loans, respectively; and the Company's, and the Bank's, Total risk based capital ratios, Tier 1 capital ratios, and Tier 1 common equity ratios were all recalculated to be 0.10%-0.20% higher than they would have been prior to this change. Certain amounts reported in previous consolidated financial statements have been reclassified and recalculated 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 Accounting Standards Update (ASU) No.2014-09, *Revenue from Contracts with Customers (Topic 606)*: ASU 2014-09 is intended to clarify the principles for recognizing revenue, and to develop common revenue standards and disclosure requirements that would: (1) remove inconsistencies and weaknesses in revenue requirements; (2) provide a more robust framework for addressing revenue issues; (3) improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; (4) provide more useful information to users of financial statements through improved disclosures; and (5) simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. The guidance affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets. The core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides steps to follow to achieve the core principle. An entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative information is required with regard to contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017, including interim periods therein, with early adoption permitted for reporting periods beginning after December 15, 2016. The Company plans to adopt ASU 2014-09 on January 1, 2018 utilizing the modified retrospective approach. Since the guidance does not apply to revenue associated with financial instruments such as loans and investments, which are accounted for under other provisions of GAAP, we do not expect it to impact interest income, our largest component of income. The Company is currently performing an overall assessment of revenue streams potentially affected by the ASU, including certain deposit related fees and interchange fees, to determine the potential impact of this guidance on our consolidated financial statements.

FASB issued Accounting Standard Update (ASU) No. 2016-02, *Leases (Topic 842)*. ASU 2016-2, among other things, requires lessees to recognize most leases on-balance sheet, increasing reported assets and liabilities. Lessor accounting remains substantially similar to current U.S. GAAP. ASU 2016-02 will be effective for the Company on January 1, 2019, utilizing the modified retrospective transition approach. The Company is currently evaluating the impact of adopting ASU 2016-02 on the Company's consolidated financial statements.

FASB issued Accounting Standard Update (ASU) No. 2016-09, *Compensation – Stock Compensation (Topic 718)*. ASU 2016-09, among other things, requires: (i) that all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) should be recognized as income tax expense or benefit in the income statement, (ii) the tax effects of exercised or vested awards should be treated as discrete items in the reporting period in which they occur, (iii) an entity also should recognize excess tax benefits regardless of whether the benefit reduces taxes payable in the current period, (iv) excess tax benefits should be classified along with other income tax cash flows as an operating activity, (v) an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur, (vi) the threshold to qualify for equity classification permits withholding up to the maximum statutory tax rates in the applicable jurisdictions, and (vii) cash paid by an employer when directly withholding shares for tax withholding purposes should be classified as a financing activity. ASU 2016-09 was effective for the Company on January 1, 2017 and due to options exercised and restricted stock units released during the three and nine months ended September 30, 2017, resulted in the recognition of excess tax benefits totaling \$150,000, and \$847,000 respectively.

FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326)*. ASU 2016-13 is the final guidance on the new current expected credit loss ("CECL") model. ASU 2016-13, among other things, requires the incurred loss impairment methodology in current GAAP be replaced with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to estimate future credit loss estimates. As CECL encompasses all financial assets carried at amortized cost, the requirement that reserves be established based on an organization's reasonable and supportable estimate of expected credit losses extends to held to maturity ("HTM") debt securities. ASU 2016-13 amends the accounting for credit losses on available-for-sale securities ("AFS"), whereby credit losses will be presented as an allowance as opposed to a write-down. In addition, CECL will modify the accounting for purchased loans with credit deterioration since origination, so that reserves are established at the date of acquisition for purchased loans. Lastly, ASU 2016-13 requires enhanced disclosures on the significant estimates and judgments used to estimate credit losses, as well as on the credit quality and underwriting standards of an organization's portfolio. These disclosures require organizations to present the currently required credit quality disclosures disaggregated by the year of origination or vintage. ASU 2016-13 allows for a modified retrospective approach with a cumulative effect adjustment to the balance sheet upon adoption (charge to retained earnings instead of the income statement). ASU 2016-13 will be effective for the Company on January 1, 2020, and early adoption is permitted. While the Company is currently evaluating the provisions of ASU 2016-13 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements, it has taken steps to prepare for the implementation when it becomes effective, such as forming an internal task force, gathering pertinent data, consulting with outside professionals, and evaluating its current IT systems. Management expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the first reporting period in which the new standard is

effective, but cannot yet estimate the magnitude of the one-time adjustment or the overall impact of the new guidance on the Company's financial position, results of operations or cash flows.

FASB issued ASU No. 2016-18, *Statement of Cash Flows - Restricted Cash (Topic 230)*. ASU 2016-18 requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. ASU 2016-18 will be effective for the Company on January 1, 2018 and is not expected to have a significant impact on the Company's consolidated financial statements.

FASB issued ASU No. 2017-01, *Business Combinations - Clarifying the Definition of a Business (Topic 805)*. ASU 2017-01 clarifies the definition and provides a more robust framework to use in determining when a set of assets and activities constitutes a business. ASU 2017-01 is intended to provide guidance when evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 will be effective for us on January 1, 2018 and is not expected to have a significant impact on our financial statements.

FASB issued ASU No. 2017-04, *Intangibles - Goodwill and Other: Simplifying the Test for Goodwill Impairment (Topic 350)*. ASU 2017-04 eliminates step two of the goodwill impairment test (the hypothetical purchase price allocation used to determine the implied fair value of goodwill) when step one (determining if the carrying value of a reporting unit exceeds its fair value) is failed. Instead, entities simply will compare the fair value of a reporting unit to its carrying amount and record goodwill impairment for the amount by which the reporting unit's carrying amount exceeds its fair value. ASU 2017-04 will be effective for the Company on January 1, 2020 and is not expected to have a significant impact on the Company's consolidated financial statements.

FASB issued ASU No. 2017-07, *Compensation - Retirement Benefits (Topic 715)*. ASU 2017-07 requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component. ASU 2017-07 will be effective for the Company on January 1, 2018 and is not expected to have a significant impact on the Company's consolidated financial statements.

FASB issued ASU 2017-08, *Receivables - Nonrefundable Fees and Other Costs (Topic 310)*. ASU 2017-08 shortens the amortization period for certain callable debt securities held at a premium to require such premiums to be amortized to the earliest call date unless applicable guidance related to certain pools of securities is applied to consider estimated prepayments. Under prior guidance, entities were generally required to amortize premiums on individual, non-pooled callable debt securities as a yield adjustment over the contractual life of the security. ASU 2017-08 does not change the accounting for callable debt securities held at a discount. ASU 2017-08 will be effective for the Company on January 1, 2019, with early adoption permitted. The Company is currently evaluating the impact of adopting ASU 2016-08 on the Company's consolidated financial statements.

FASB issued ASU 2017-09, *Compensation - Stock Compensation (Topic 718)*. ASU 2017-09 clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. Under ASU 2017-09, an entity will not apply modification accounting to a share-based payment award if all of the following are the same immediately before and after the change: (i) the award's fair value, (ii) the award's vesting conditions and (iii) the award's classification as an equity or liability instrument. ASU 2017-09 will be effective for the Company on January 1, 2018 and is not expected to have a significant impact on the Company's consolidated financial statements.

## Note 2 - Business Combinations

On March 18, 2016, the Bank completed its acquisition of three branch banking offices from Bank of America originally announced October 28, 2015. The acquired branches are located in Arcata, Eureka and Fortuna in Humboldt County on the North Coast of California, and have significant overlap compared to the Company's then-existing Northern California customer base and branch locations. Beginning on March 18, 2016, the revenue and expenses from the operations of the acquired branches are included in the results of the Company. The Bank paid a premium of \$3,204,000 for deposit relationships with balances of \$161,231,000 and loans with balances of \$289,000.

The assets acquired and liabilities assumed in the acquisition of these branches were accounted for in accordance with ASC 805 "Business Combinations," using the acquisition method of accounting and were recorded at their estimated fair values on the March 18, 2016 acquisition date, and the results of operations of the acquired branches are included in the Company's consolidated statements of income since that date. The excess of the fair value of consideration transferred over total identifiable net assets was recorded as goodwill. The goodwill arising from the acquisition consists largely of the synergies and economies of scale expected from combining the operations of the Company and the acquired branches. \$849,000 of the goodwill is deductible for income tax purposes because the acquisition was accounted for as a purchase of assets and assumption of liabilities for tax purposes.

The following table discloses the calculation of the fair value of consideration transferred, the total identifiable net assets acquired and the resulting goodwill relating to the acquisition of three branch banking offices and certain deposits from Bank of America on March 18, 2016:

(in thousands)	<u>March 18, 2016</u>
Fair value of consideration transferred:	
Cash consideration	<u>\$3,204</u>
Total fair value of consideration transferred	<u>3,204</u>
Asset acquired:	
Cash and cash equivalents	159,520
Loans	289
Premises and equipment	1,590
Core deposit intangible	2,046
Other assets	141
Total assets acquired	<u>163,586</u>
Liabilities assumed:	
Deposits	<u>161,231</u>
Total liabilities assumed	<u>161,231</u>
Total net assets acquired	<u>2,355</u>
Goodwill recognized	<u>\$849</u>

A summary of the cash paid and estimated fair value adjustments resulting in the goodwill recorded in the acquisition of three branch banking offices and certain deposits from Bank of America on March 18, 2016 are presented below:

(in thousands)	<u>March 18, 2016</u>
Cash paid	\$3,204
Cost basis net assets acquired	-
Fair value adjustments:	
Loans	-
Premises and Equipment	(309)
Core deposit intangible	<u>(2,046)</u>
Goodwill	<u>\$849</u>

As part of the acquisition of three branch banking offices from Bank of America, the Company performed a valuation of premises and equipment acquired. This valuation resulted in a \$309,000 increase in the net book value of the land and buildings acquired, and was based on current appraisals of such land and buildings.

The Company recognized a core deposit intangible of \$2,046,000 related to the acquisition of the core deposits. The recorded core deposit intangibles represented approximately 1.50% of the core deposits acquired and will be amortized over their estimated useful lives of 7 years.

A valuation of the time deposits acquired was also performed as of the acquisition date. Time deposits were split into similar pools based on size, type of time deposits, and maturity. A discounted cash flow analysis was performed on the pools based on current market rates currently paid on similar time deposits. The valuation resulted in no material fair value discount or premium, and none was recorded.

**Note 3 - Investment Securities**

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

	September 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
(in thousands)				
<u>Securities Available for Sale</u>				
Obligations of U.S. government corporations and agencies	\$557,060	\$1,321	\$(4,319)	\$554,062
Obligations of states and political subdivisions	121,635	1,182	(1,600)	121,217
Marketable equity securities	3,000	-	(43)	2,957
Total securities available for sale	<u>\$681,695</u>	<u>\$2,503</u>	<u>\$(5,962)</u>	<u>\$678,236</u>
<u>Securities Held to Maturity</u>				
Obligations of U.S. government corporations and agencies	\$521,999	\$6,837	\$(1,442)	\$527,394
Obligations of states and political subdivisions	14,568	211	(50)	14,729
Total securities held to maturity	<u>\$536,567</u>	<u>\$7,048</u>	<u>\$(1,492)</u>	<u>\$542,123</u>
December 31, 2016				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
(in thousands)				
<u>Securities Available for Sale</u>				
Obligations of U.S. government corporations and agencies	\$434,357	\$1,949	\$(6,628)	\$429,678
Obligations of states and political subdivisions	121,746	267	(4,396)	117,617
Marketable equity securities	3,000	-	(62)	2,938
Total securities available for sale	<u>\$559,103</u>	<u>\$2,216</u>	<u>\$(11,086)</u>	<u>\$550,233</u>
<u>Securities Held to Maturity</u>				
Obligations of U.S. government corporations and agencies	\$587,982	\$5,001	\$(4,199)	\$588,784
Obligations of states and political subdivisions	14,554	56	(191)	14,419
Total securities held to maturity	<u>\$602,536</u>	<u>\$5,057</u>	<u>\$(4,390)</u>	<u>\$603,203</u>

During the three months ended September 30, 2017 investment securities with cost basis of \$25,757,000 were sold. No investment securities were sold during the six months ended June 30, 2017 or the nine months ended September 30, 2016. Investment securities with an aggregate carrying value of \$268,076,000 and \$292,737,000 at September 30, 2017 and December 31, 2016, 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 September 30, 2017 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 September 30, 2017, obligations of U.S. government corporations and agencies with a cost basis totaling \$1,079,060,000 consist almost entirely of residential real estate 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 September 30, 2017, 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 (In thousands)	Available for Sale		Held to Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year	\$2	\$2	-	-
Due after one year through five years	206	206	\$1,199	\$1,233
Due after five years through ten years	2,223	2,279	4,098	4,165
Due after ten years	679,264	675,749	531,270	536,725
Totals	<u>\$681,695</u>	<u>\$678,236</u>	<u>\$536,567</u>	<u>\$542,123</u>

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	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
September 30, 2017	(in thousands)					
Securities Available for Sale:						
Obligations of U.S. government corporations and agencies	\$365,252	\$(4,319)	-	-	\$365,252	\$(4,319)
Obligations of states and political subdivisions	31,937	(903)	\$8,905	\$(697)	40,842	(1,600)
Marketable equity securities	2,957	(43)	-	-	2,957	(43)
<b>Total securities available-for-sale</b>	<b>\$400,146</b>	<b>\$(5,265)</b>	<b>\$8,905</b>	<b>\$(697)</b>	<b>\$409,051</b>	<b>\$(5,962)</b>
Securities Held to Maturity:						
Obligations of U.S. government corporations and agencies	\$133,453	\$(1,442)	-	-	\$133,453	\$(1,442)
Obligations of states and political subdivisions	3,197	(50)	-	-	3,179	(50)
<b>Total securities held-to-maturity</b>	<b>\$136,650</b>	<b>\$(1,492)</b>	<b>-</b>	<b>-</b>	<b>\$136,650</b>	<b>\$(1,492)</b>
December 31, 2016	(in thousands)					
Securities Available for Sale:						
Obligations of U.S. government corporations and agencies	\$370,389	\$(6,628)	-	-	\$370,389	\$(6,628)
Obligations of states and political subdivisions	90,825	(4,396)	-	-	90,825	(4,396)
Marketable equity securities	2,938	(62)	-	-	2,938	(62)
<b>Total securities available-for-sale</b>	<b>\$464,152</b>	<b>\$(11,086)</b>	<b>-</b>	<b>-</b>	<b>\$464,152</b>	<b>\$(11,086)</b>
Securities Held to Maturity:						
Obligations of U.S. government corporations and agencies	\$280,497	\$(4,199)	-	-	\$280,497	\$(4,199)
Obligations of states and political subdivisions	9,984	(191)	-	-	9,984	(191)
<b>Total securities held-to-maturity</b>	<b>\$290,481</b>	<b>\$(4,390)</b>	<b>-</b>	<b>-</b>	<b>\$290,481</b>	<b>\$(4,390)</b>

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 September 30, 2017, 51 debt securities representing obligations of U.S. government corporations and agencies had unrealized losses with aggregate depreciation of (1.14%) 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 September 30, 2017, 48 debt securities representing obligations of states and political subdivisions had unrealized losses with aggregate depreciation of (3.61%) from the Company's amortized cost basis.

Marketable equity securities: At September 30, 2017, 2 marketable equity securities had unrealized losses with aggregate depreciation of (1.43%) from the Company's amortized cost basis. The Company has the intent and ability to hold these securities for the foreseeable future and no credit quality deterioration associated with these securities has been identified, therefore, management does not believe that they are other than temporarily impaired.



**Note 4 – Loans**

A summary of loan balances follows (in thousands):

	September 30, 2017				Total
	Originated	PNCI	PCI - Cash basis	PCI - Other	
Mortgage loans on real estate:					
Residential 1-4 family	\$321,852	\$67,815	-	\$1,405	\$391,072
Commercial	1,588,790	206,841	-	8,171	1,803,802
Total mortgage loan on real estate	1,910,642	274,656	-	9,576	2,194,874
Consumer:					
Home equity lines of credit	269,470	17,084	\$2,209	743	289,506
Home equity loans	41,486	2,810	-	737	45,033
Other	24,435	2,302	-	44	26,781
Total consumer loans	335,391	22,196	2,209	1,524	361,320
Commercial	215,946	8,838	-	2,695	227,479
Construction:					
Residential	75,108	12	-	-	75,120
Commercial	69,452	3,368	-	-	72,820
Total construction	144,560	3,380	-	-	147,940
Total loans, net of deferred loan fees and discounts	<u>\$2,606,539</u>	<u>\$309,070</u>	<u>\$2,209</u>	<u>\$13,795</u>	<u>\$2,931,613</u>
Total principal balance of loans owed, net of charge-offs	\$2,614,521	\$316,657	\$6,519	\$17,626	\$2,955,323
Unamortized net deferred loan fees	(7,982)	-	-	-	(7,982)
Discounts to principal balance of loans owed, net of charge-offs	-	(7,587)	(4,310)	(3,831)	(15,728)
Total loans, net of deferred loan fees and discounts	<u>\$2,606,539</u>	<u>\$309,070</u>	<u>\$2,209</u>	<u>\$13,795</u>	<u>\$2,931,613</u>
Noncovered loans	\$2,606,539	\$309,070	\$2,209	\$13,795	\$2,931,613
Covered loans	-	-	-	-	-
Total loans, net of deferred loan fees and discounts	<u>\$2,606,539</u>	<u>\$309,070</u>	<u>\$2,209</u>	<u>\$13,795</u>	<u>\$2,931,613</u>
Allowance for loan losses	<u>\$(27,417)</u>	<u>\$(1,043)</u>	<u>\$(12)</u>	<u>\$(275)</u>	<u>\$(28,747)</u>

**Note 4 – Loans (continued)**

A summary of loan balances follows (in thousands):

	December 31, 2016				
	Originated	PNCI	PCI - Cash basis	PCI - Other	Total
Mortgage loans on real estate:					
Residential 1-4 family	\$284,539	\$82,335	-	\$1,469	\$368,343
Commercial	1,425,828	246,491	-	12,802	1,685,121
Total mortgage loan on real estate	1,710,367	328,826	-	14,271	2,053,464
Consumer:					
Home equity lines of credit	263,590	21,765	\$2,983	1,377	289,715
Home equity loans	40,736	3,764	-	1,682	46,182
Other	28,167	2,534	-	65	30,766
Total consumer loans	332,493	28,063	2,983	3,124	366,663
Commercial	200,735	12,321	-	3,991	217,047
Construction:					
Residential	54,613	141	-	675	55,429
Commercial	58,119	8,871	-	-	66,990
Total construction	112,732	9,012	-	675	122,419
Total loans, net of deferred loan fees and discounts	<u>\$2,356,327</u>	<u>\$378,222</u>	<u>\$2,983</u>	<u>\$22,061</u>	<u>\$2,759,593</u>
Total principal balance of loans owed, net of charge-offs	\$2,363,243	\$388,139	\$8,280	\$25,650	\$2,785,312
Unamortized net deferred loan fees	(6,916)	-	-	-	(6,916)
Discounts to principal balance of loans owed, net of charge-offs	-	(9,917)	(5,297)	(3,589)	(18,803)
Total loans, net of unamortized deferred loan fees and discounts	<u>\$2,356,327</u>	<u>\$378,222</u>	<u>\$2,983</u>	<u>\$22,061</u>	<u>\$2,759,593</u>
Noncovered loans	\$2,356,327	\$378,222	\$2,983	\$18,885	\$2,756,417
Covered loans	-	-	-	3,176	3,176
Total loans, net of unamortized deferred loan fees and discounts	<u>\$2,356,327</u>	<u>\$378,222</u>	<u>\$2,983</u>	<u>\$22,061</u>	<u>\$2,759,593</u>
Allowance for loan losses	<u>\$(28,141)</u>	<u>\$(1,665)</u>	<u>\$(17)</u>	<u>\$(2,680)</u>	<u>\$(32,503)</u>

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

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Change in accretable yield:				
Balance at beginning of period	\$7,956	\$11,775	\$10,348	\$13,255
Accretion to interest income	(594)	(961)	(2,554)	(3,068)
Reclassification (to) from nonaccretable difference	(2,893)	(160)	(3,325)	467
Balance at end of period	<u>\$4,469</u>	<u>\$10,654</u>	<u>\$4,469</u>	<u>\$10,654</u>

## 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 – Three Months Ended September 30, 2017									
(in thousands)	RE Mortgage		Home Equity		Other		Construction		Total
	Resid.	Comm.	Lines	Loans	Consum.	C&I	Resid.	Comm.	
Beginning balance	\$2,495	\$10,119	\$6,156	\$2,354	\$645	\$4,729	\$1,179	\$466	\$28,143
Charge-offs	(60)	(20)	(14)	(94)	(349)	(291)	(33)	-	(861)
Recoveries	-	238	189	121	91	61	-	-	700
(Benefit) provision	(217)	1,033	(610)	(390)	203	303	284	159	765
Ending balance	\$2,218	\$11,370	\$5,721	\$1,991	\$590	\$4,802	\$1,430	\$625	\$28,747

Allowance for Loan Losses – Nine Months Ended September 30, 2017									
(in thousands)	RE Mortgage		Home Equity		Other		Construction		Total
	Resid.	Comm.	Lines	Loans	Consum.	C&I	Resid.	Comm.	
Beginning balance	\$2,748	\$11,517	\$7,044	\$2,644	\$622	\$5,831	\$1,417	\$680	\$32,503
Charge-offs	(60)	(170)	(98)	(331)	(831)	(1,188)	(1,104)	-	(3,782)
Recoveries	-	365	487	146	300	315	-	1	1,614
(Benefit) provision	(470)	(342)	(1,712)	(468)	499	(156)	1,117	(56)	(1,588)
Ending balance	\$2,218	\$11,370	\$5,721	\$1,991	\$590	\$4,802	\$1,430	\$625	\$28,747
Ending balance:									
Individ. evaluated for impairment	\$240	\$73	\$363	\$111	\$77	\$1,276	-	-	\$2,140
Loans pooled for evaluation	\$1,978	\$11,022	\$5,347	\$1,879	\$513	\$3,526	\$1,430	\$625	\$26,320
Loans acquired with deteriorated credit quality	-	\$275	\$12	-	-	-	-	-	\$287

Loans, net of unearned fees – As of September 30, 2017									
(in thousands)	RE Mortgage		Home Equity		Other		Construction		Total
	Resid.	Comm.	Lines	Loans	Consum.	C&I	Resid.	Comm.	
Ending balance:									
Total loans	\$391,072	\$1,803,802	\$289,506	\$45,033	\$26,781	\$227,479	\$75,120	\$72,820	\$2,931,613
Individ. evaluated for impairment	\$5,027	\$19,788	\$2,219	\$1,842	\$267	\$2,938	\$144	-	\$32,225
Loans pooled for evaluation	\$384,640	\$1,775,843	\$284,335	\$42,454	\$26,470	\$221,846	\$74,976	\$72,820	\$2,883,384
Loans acquired with deteriorated credit quality	\$1,405	\$8,171	\$2,952	\$737	\$44	\$2,695	-	-	\$16,004

Allowance for Loan Losses - Year Ended December 31, 2016									
(in thousands)	RE Mortgage		Home Equity		Other		Construction		Total
	Resid.	Comm.	Lines	Loans	Consum.	C&I	Resid.	Comm.	
Beginning balance	\$2,896	\$11,015	\$11,253	\$3,177	\$688	\$5,271	\$899	\$812	\$36,011
Charge-offs	(321)	(827)	(585)	(219)	(823)	(455)	-	-	(3,230)
Recoveries	880	920	2,317	590	449	404	54	78	5,692
(Benefit) provision	(694)	395	(5,940)	(903)	308	611	463	(210)	(5,970)
Ending balance	\$2,761	\$11,503	\$7,045	\$2,645	\$622	\$5,831	\$1,416	\$680	\$32,503
Ending balance:									
Individ. evaluated for impairment	\$258	\$4	\$411	\$215	\$28	\$1,130	-	-	\$2,046
Loans pooled for evaluation	\$2,317	\$10,050	\$6,617	\$2,366	\$594	\$3,765	\$1,371	\$680	\$27,760
Loans acquired with deteriorated credit quality	\$186	\$1,449	\$17	\$64	-	\$936	\$45	-	\$2,697

**Note 5 – Allowance for Loan Losses (continued)**

Loans, net of unearned fees – As of December 31, 2016										
(in thousands)	RE Mortgage		Home Equity		Other Consum.	C&I	Construction		Total	
	Resid.	Comm.	Lines	Loans			Resid.	Comm.		
Ending balance:										
Total loans	\$368,343	\$1,685,121	\$289,715	\$46,182	\$30,766	\$217,047	\$55,429	\$66,990	\$2,759,593	
Individ. evaluated for impairment	\$4,094	\$15,081	\$3,196	\$1,508	\$154	\$4,096	\$11	-	\$28,140	
Loans pooled for evaluation	\$362,780	\$1,657,238	\$282,159	\$42,992	\$30,547	\$208,960	\$54,743	\$66,990	\$2,706,409	
Loans acquired with deteriorated credit quality	\$1,469	\$12,802	\$4,360	\$1,682	\$65	\$3,991	\$675	-	\$25,044	

  

Allowance for Loan Losses – Three Months Ended September 30, 2016										
(in thousands)	RE Mortgage		Home Equity		Auto Indirect	Other Consum.	C&I	Construction		Total
	Resid.	Comm.	Lines	Loans				Resid.	Comm.	
Beginning balance	\$3,081	\$11,934	\$9,203	\$3,057	-	\$696	\$5,265	\$1,321	\$952	\$35,509
Charge-offs	(50)	-	(122)	(25)	-	(160)	(307)	-	-	(664)
Recoveries	391	20	1,580	429	-	107	85	-	-	2,612
(Benefit) provision	(653)	(378)	(2,261)	(360)	-	24	199	(16)	(528)	(3,973)
Ending balance	\$2,769	\$11,576	\$8,400	\$3,101	-	\$667	\$5,242	\$1,305	\$424	\$33,484

  

Allowance for Loan Losses – Nine Months Ended September 30, 2016										
(in thousands)	RE Mortgage		Home Equity		Auto Indirect	Other Consum.	C&I	Construction		Total
	Resid.	Comm.	Lines	Loans				Resid.	Comm.	
Beginning balance	\$2,896	\$11,015	\$11,253	\$3,177	-	\$688	\$5,271	\$899	\$812	\$36,011
Charge-offs	(212)	(793)	(450)	(118)	-	(600)	(421)	-	-	(2,594)
Recoveries	618	902	1,921	501	-	338	323	-	1	4,604
(Benefit) provision	(533)	452	(4,324)	(459)	-	241	69	406	(389)	(4,537)
Ending balance	\$2,769	\$11,576	\$8,400	\$3,101	-	\$667	\$5,242	\$1,305	\$424	\$33,484
Ending balance:										
Individ. evaluated for impairment	\$418	\$644	\$511	\$311	-	\$72	\$822	-	-	\$2,778
Loans pooled for evaluation	\$2,157	\$9,493	\$7,864	\$2,730	-	\$595	\$3,426	\$1,257	\$424	\$27,946
Loans acquired with deteriorated credit quality	\$181	\$1,453	\$25	\$59	-	-	\$994	\$48	-	\$2,760

  

Loans, net of unearned fees – As of September 30, 2016										
(in thousands)	RE Mortgage		Home Equity		Auto Indirect	Other Consum.	C&I	Construction		Total
	Resid.	Comm.	Lines	Loans				Resid.	Comm.	
Ending balance:										
Total loans	\$368,223	\$1,625,897	\$301,884	\$48,314	-	\$31,611	\$217,110	\$57,892	\$61,295	\$2,712,226
Individ. evaluated for impairment	\$5,414	\$14,706	\$3,820	\$2,650	-	\$278	\$2,397	\$11	-	\$29,276
Loans pooled for evaluation	\$361,336	\$1,597,876	\$292,833	\$43,552	-	\$31,272	\$210,565	\$57,338	\$61,295	\$2,656,067
Loans acquired with deteriorated credit quality	\$1,473	\$13,315	\$5,231	\$2,112	-	\$61	\$4,148	\$543	-	\$26,883

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.

## Note 5 – Allowance for Loan Losses (continued)

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 September 30, 2017									
(in thousands)	RE Mortgage		Home Equity		Other		Construction		Total
	Resid.	Comm.	Lines	Loans	Consum.	C&I	Resid.	Comm.	
Originated loans:									
Pass	\$317,577	\$1,553,178	\$266,066	\$38,885	\$23,978	\$209,215	\$75,000	\$60,921	\$2,544,820
Special mention	1,831	13,484	2,196	815	368	3,390	-	8,531	30,615
Substandard	2,444	22,128	1,208	1,786	89	3,341	108	-	31,104
Loss	-	-	-	-	-	-	-	-	-
Total originated	\$321,852	\$1,588,790	\$269,470	\$41,486	\$24,435	\$215,946	\$75,108	\$69,452	\$2,606,539
PNCI loans:									
Pass	\$65,700	\$191,518	\$15,832	\$2,534	\$2,257	\$8,832	\$12	\$3,368	\$290,053
Special mention	223	13,155	452	209	39	-	-	-	14,078
Substandard	1,892	2,168	800	67	6	6	-	-	4,939
Loss	-	-	-	-	-	-	-	-	-
Total PNCI	\$67,815	\$206,841	\$17,084	\$2,810	\$2,302	\$8,838	\$12	\$3,368	\$309,070
PCI loans	\$1,405	\$8,171	\$2,952	\$737	\$44	\$2,695	-	-	\$16,004
Total loans	\$391,072	\$1,803,802	\$289,506	\$45,033	\$26,781	\$227,479	\$75,120	\$72,820	\$2,931,613

Credit Quality Indicators – As of December 31, 2016									
(in thousands)	RE Mortgage		Home Equity		Other		Construction		Total
	Resid.	Comm.	Lines	Loans	Consum.	C&I	Resid.	Comm.	
Originated loans:									
Pass	\$278,635	\$1,399,936	\$258,024	\$37,844	\$27,542	\$190,902	\$54,602	\$57,808	\$2,305,293
Special mention	2,992	14,341	2,518	891	385	6,133	-	311	27,571
Substandard	2,912	11,551	3,048	2,001	240	3,700	11	-	23,463
Loss	-	-	-	-	-	-	-	-	-
Total originated	\$284,539	\$1,425,828	\$263,590	\$40,736	\$28,167	\$200,735	\$54,613	\$58,119	\$2,356,327
PNCI loans:									
Pass	\$79,000	\$233,326	\$20,442	\$3,506	\$2,437	\$12,320	\$141	\$8,871	\$360,043
Special mention	1,849	5,925	509	173	92	1	-	-	8,549
Substandard	1,486	7,240	814	85	5	-	-	-	9,630
Loss	-	-	-	-	-	-	-	-	-
Total PNCI	\$82,335	\$246,491	\$21,765	\$3,764	\$2,534	\$12,321	\$141	\$8,871	\$378,222
PCI loans	\$1,469	\$12,802	\$4,360	\$1,682	\$65	\$3,991	\$675	-	\$25,044
Total loans	\$368,343	\$1,685,121	\$289,715	\$46,182	\$30,766	\$217,047	\$55,429	\$66,990	\$2,759,593

## Note 5 – Allowance for Loan Losses (continued)

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 September 30, 2017									
(in thousands)	RE Mortgage		Home Equity		Other		Construction		Total
	Resid.	Comm.	Lines	Loans	Consum.	C&I	Resid.	Comm.	
Originated loan balance:									
Past due:									
30-59 Days	\$721	\$2,241	\$695	\$662	\$150	\$362	-	-	\$4,831
60-89 Days	403	793	299	-	83	1	-	-	1,579
> 90 Days	343	744	82	468	1	407	-	-	2,045
Total past due	1,467	3,778	1,076	1,130	234	770	-	-	8,455
Current	320,385	1,585,012	268,394	40,356	24,201	215,176	75,108	69,452	2,598,084
Total orig. loans	\$321,852	\$1,588,790	\$269,470	\$41,486	\$24,435	\$215,946	\$75,108	\$69,452	\$2,606,539
> 90 Days and still accruing	-	-	-	-	-	-	-	-	-
Nonaccrual loans	\$1,037	\$6,954	\$534	\$1,199	\$13	\$1,951	-	-	\$11,688

**Note 5 – Allowance for Loan Losses (continued)**

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 September 30, 2017									
(in thousands)	RE Mortgage		Home Equity		Other Consum.	C&I	Construction		Total
	Resid.	Comm.	Lines	Loans			Resid.	Comm.	
PNCI loan balance:									
Past due:									
30-59 Days	\$39	-	\$100	\$27	\$12	-	-	-	\$178
60-89 Days	159	1,599	129	18	5	1	-	-	1,911
> 90 Days	1,021	-	-	-	-	6	-	-	\$1,027
Total past due	1,219	1,599	229	45	17	7	-	-	3,116
Current	66,596	205,242	16,855	2,765	2,285	8,831	12	3,368	305,954
Total PNCI loans	\$67,815	\$206,841	\$17,084	\$2,810	\$2,302	\$8,838	\$12	\$3,368	\$309,070
> 90 Days and still accruing	-	-	-	-	-	-	-	-	-
Nonaccrual loans	\$1,089	\$1,599	\$276	\$50	\$6	\$6	-	-	\$3,026

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, 2016									
(in thousands)	RE Mortgage		Home Equity		Other Consum.	C&I	Construction		Total
	Resid.	Comm.	Lines	Loans			Resid.	Comm.	
Originated loan balance:									
Past due:									
30-59 Days	\$552	\$317	\$754	\$646	\$16	\$1,148	\$921	-	\$4,354
60-89 Days	269	1,387	-	395	30	84	-	\$421	2,586
> 90 Days	-	216	687	184	15	634	11	-	1,747
Total past due	821	1,920	1,441	1,225	61	1,866	932	421	8,687
Current	283,718	1,423,908	262,149	39,511	28,106	198,869	53,681	57,698	2,347,640
Total orig. loans	\$284,539	\$1,425,828	\$263,590	\$40,736	\$28,167	\$200,735	\$54,613	\$58,119	\$2,356,327
> 90 Days and still accruing	-	-	-	-	-	-	-	-	-
Nonaccrual loans	\$255	\$7,651	\$1,211	\$803	\$33	\$2,930	\$11	-	\$12,894

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, 2016									
(in thousands)	RE Mortgage		Home Equity		Other Consum.	C&I	Construction		Total
	Resid.	Comm.	Lines	Loans			Resid.	Comm.	
PNCI loan balance:									
Past due:									
30-59 Days	\$1,510	\$73	\$274	\$39	-	-	-	-	\$1,896
60-89 Days	-	-	-	-	-	-	-	-	-
> 90 Days	21	81	589	13	-	-	-	-	704
Total past due	1,531	154	863	52	-	-	-	-	2,600
Current	80,804	246,337	20,902	3,712	\$2,534	\$12,321	\$141	\$8,871	375,622
Total PNCI loans	\$82,335	\$246,491	\$21,765	\$3,764	\$2,534	\$12,321	\$141	\$8,871	\$378,222
> 90 Days and still accruing	-	-	-	-	-	-	-	-	-
Nonaccrual loans	\$194	\$1,826	\$742	\$67	\$5	-	-	-	\$2,834

**Note 5 – Allowance for Loan Losses (continued)**

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 original 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, or for the Nine Months Ended, September 30, 2017									
(in thousands)	RE Mortgage		Home Equity		Other Consum.	C&I	Construction		Total
	Resid.	Comm.	Lines	Loans			Resid.	Comm.	
With no related allowance recorded:									
Recorded investment	\$1,777	\$17,039	\$1,108	\$1,470	\$3	\$884	\$144	-	\$22,425
Unpaid principal	\$1,819	\$17,493	\$1,209	\$1,892	\$47	\$1,139	\$144	-	\$23,743
Average recorded									
Investment	\$1,734	\$15,092	\$1,294	\$1,034	\$9	\$823	\$78	-	\$20,064
Interest income Recognized	\$51	\$474	\$25	\$25	(\$25)	\$16	\$7	-	\$573
With an allowance recorded:									
Recorded investment	\$1,644	\$1,150	\$110	\$199	\$11	\$2,048	-	-	\$5,162
Unpaid principal	\$1,670	\$1,150	\$115	\$199	\$12	\$2,123	-	-	\$5,269
Related allowance	\$167	\$73	\$33	\$13	\$7	\$1,270	-	-	\$1,563
Average recorded									
Investment	\$1,508	\$898	\$270	\$342	\$14	\$2,691	-	-	\$5,723
Interest income Recognized	\$39	\$40	-	\$7	-	\$53	-	-	\$139
Impaired PNCI Loans – As of, or for the Nine Months Ended, September 30, 2017									
(in thousands)	RE Mortgage		Home Equity		Other Consum.	C&I	Construction		Total
	Resid.	Comm.	Lines	Loans			Resid.	Comm.	
With no related allowance recorded:									
Recorded investment	\$1,356	\$1,599	\$394	\$50	-	-	-	-	\$3,399
Unpaid principal	\$1,384	\$1,869	\$413	\$62	-	-	-	-	\$3,728
Average recorded									
Investment	\$910	\$1,712	\$564	\$59	\$2	-	-	-	\$3,247
Interest income Recognized	\$17	-	\$8	-	-	-	-	-	\$25
With an allowance recorded:									
Recorded investment	\$250	-	\$607	\$123	\$253	\$6	-	-	\$1,239
Unpaid principal	\$250	-	\$607	\$123	\$253	\$6	-	-	\$1,239
Related allowance	\$73	-	\$328	\$99	\$71	\$6	-	-	\$577
Average recorded									
Investment	\$255	\$66	\$579	\$62	\$185	\$3	-	-	\$1,150
Interest income Recognized	\$7	-	\$20	\$5	\$8	-	-	-	\$40



**Note 5 – Allowance for Loan Losses (continued)**

		Impaired Originated Loans – As of December 31, 2016								
		RE Mortgage		Home Equity		Other		Construction		Total
(in thousands)		Resid.	Comm.	Lines	Loans	Consum.	C&I	Resid.	Comm.	
With no related allowance recorded:										
Recorded investment		\$1,821	\$12,897	\$1,480	\$715	\$15	\$762	\$11	-	\$17,701
Unpaid principal		\$1,829	\$13,145	\$1,561	\$1,135	\$29	\$926	\$16	-	\$18,641
Average recorded										
Investment		\$2,853	\$20,003	\$2,221	\$831	\$17	\$669	\$7	-	\$26,601
Interest income										
Recognized		\$92	\$570	\$40	\$6	\$1	\$48	-	-	\$757
With an allowance recorded:										
Recorded investment		\$1,551	\$357	\$430	\$594	\$19	\$3,334	-	-	\$6,285
Unpaid principal		\$1,552	\$357	\$440	\$596	\$19	\$3,385	-	-	\$6,349
Related allowance		\$180	\$4	\$110	\$107	\$13	\$1,130	-	-	\$1,544
Average recorded										
Investment		\$1,779	\$888	\$1,076	\$634	\$9	\$2,714	-	-	\$7,100
Interest income										
Recognized		\$65	\$22	\$9	\$31	\$2	\$77	-	-	\$206
		Impaired PNCI Loans – As of December 31, 2016								
		RE Mortgage		Home Equity		Other		Construction		Total
(in thousands)		Resid.	Comm.	Lines	Loans	Consum.	C&I	Resid.	Comm.	
With no related allowance recorded:										
Recorded investment		\$463	\$1,826	\$735	\$67	\$3	-	-	-	\$3,094
Unpaid principal		\$486	\$2,031	\$746	\$74	\$4	-	-	-	\$3,341
Average recorded										
Investment		\$669	\$1,479	\$594	\$69	\$18	\$1	-	\$245	\$3,075
Interest income										
Recognized		\$7	-	\$9	\$1	-	-	-	-	\$17
With an allowance recorded:										
Recorded investment		\$259	-	\$551	\$132	\$118	-	-	-	\$1,060
Unpaid principal		\$259	-	\$551	\$132	\$118	-	-	-	\$1,060
Related allowance		\$79	-	\$300	\$108	\$15	-	-	-	\$502
Average recorded										
Investment		\$130	\$1,374	\$579	\$85	\$176	-	-	-	\$2,344
Interest income										
Recognized		\$10	-	\$27	\$7	\$5	-	-	-	\$49

**Note 5 – Allowance for Loan Losses (continued)**

(in thousands)	Impaired Originated Loans – As of, or for the Nine Months Ended, September 30, 2016									
	RE Mortgage		Home Equity		Auto Indirect	Other Consum.	C&I	Construction		Total
	Resid.	Comm.	Lines	Loans				Resid.	Comm.	
With no related allowance recorded:										
Recorded investment	\$2,392	\$7,011	\$1,888	\$1,360	-	\$7	\$574	\$11	-	\$13,243
Unpaid principal	\$3,083	\$7,286	\$2,318	\$1,979	-	\$11	\$749	\$16	-	\$15,442
Average recorded										
Investment	\$3,139	\$17,059	\$2,425	\$1,154	\$1	\$12	\$575	\$7	-	\$24,372
Interest income										
Recognized	\$63	\$232	\$26	\$9	-	-	\$26	-	-	\$356
With an allowance recorded:										
Recorded investment	\$2,613	\$5,820	\$923	\$1,059	-	\$8	\$1,823	-	-	\$12,246
Unpaid principal	\$2,701	\$5,843	\$931	\$1,115	-	\$8	\$1,869	-	-	\$12,467
Related allowance	\$381	\$644	\$263	\$201	-	\$3	\$822	-	-	\$2,314
Average recorded										
Investment	\$2,309	\$3,620	\$1,324	\$866	-	\$4	\$1,959	-	-	\$10,082
Interest income										
Recognized	\$68	\$216	\$16	\$36	-	-	\$55	-	-	\$391

(in thousands)	Impaired PNCI Loans – As of, or for the Nine Months Ended, September 30, 2016									
	RE Mortgage		Home Equity		Auto Indirect	Other Consum.	C&I	Construction		Total
	Resid.	Comm.	Lines	Loans				Resid.	Comm.	
With no related allowance recorded:										
Recorded investment	\$474	\$1,874	\$502	\$97	-	\$6	-	-	-	\$2,953
Unpaid principal	\$492	\$2,048	\$573	\$103	-	\$7	-	-	-	\$3,223
Average recorded										
Investment	\$674	\$1,503	\$478	\$84	-	\$19	\$1	-	\$245	\$3,004
Interest income										
Recognized	\$7	-	\$2	\$1	-	-	-	-	-	\$10
With an allowance recorded:										
Recorded investment	\$263	-	\$507	\$134	-	\$257	-	-	-	\$1,161
Unpaid principal	\$263	-	\$507	\$134	-	\$257	-	-	-	\$1,161
Related allowance	\$81	-	\$248	\$109	-	\$69	-	-	-	\$507
Average recorded										
Investment	\$131	\$1,374	\$557	\$86	-	\$246	-	-	-	\$2,394
Interest income										
Recognized	\$7	-	\$16	\$5	-	\$8	-	-	-	\$36

At September 30, 2017, \$13,352,000 of originated loans were TDR and classified as impaired. The Company had obligations to lend additional \$209,000 on these TDR as of September 30, 2017. At September 30, 2017, \$1,611,000 of PNCI loans were TDR and classified as impaired. The Company had obligations to lend \$3,000 of additional funds on these TDR as of September 30, 2017.

At December 31, 2016, \$12,371,000 of Originated loans were TDRs and classified as impaired. The Company had obligations to lend \$25,000 of additional funds on these TDRs as of December 31, 2016. At December 31, 2016, \$1,324,000 of PNCI loans were TDRs and classified as impaired. The Company had no obligations to lend additional funds on these TDRs as of December 31, 2016.

At September 30, 2016, \$14,882,000 of originated loans were TDR and classified as impaired. The Company had obligations to lend \$65,000 of additional funds on these TDR as of September 30, 2016. At September 30, 2016, \$1,476,000 of PNCI loans were TDR and classified as impaired. The Company had no obligations to lend additional funds on these TDR as of September 30, 2016.

**Note 5 – Allowance for Loan Losses (continued)**

The following tables show certain information regarding Troubled Debt Restructurings (TDRs) that occurred during the periods indicated:

TDR Information for the Three Months Ended September 30, 2017									
(\$ in thousands)	RE Mortgage		Home Equity		Other		Construction		Total
	Resid.	Comm.	Lines	Loans	Consum.	C&I	Resid.	Comm.	
Number	1	4	-	1	-	8	1	-	15
Pre-mod outstanding principal balance	\$939	\$2,886	-	\$252	-	\$1,109	\$144	-	\$5,330
Post-mod outstanding principal balance	\$939	\$2,886	-	\$252	-	\$1,109	\$144	-	\$5,330
Financial impact due to TDR taken as additional provision	\$169	\$14	-	-	-	\$28	-	-	\$211
Number that defaulted during the period	1	1	-	-	-	-	-	-	2
Recorded investment of TDRs that defaulted during the period	\$99	\$219	-	-	-	-	-	-	\$318
Financial impact due to the default of previous TDR taken as charge-offs or additional provisions	-	-	-	-	-	-	-	-	-

TDR Information for the Nine Months Ended September 30, 2017									
(\$ in thousands)	RE Mortgage		Home Equity		Other		Construction		Total
	Resid.	Comm.	Lines	Loans	Consum.	C&I	Resid.	Comm.	
Number	1	7	3	1	1	11	1	-	25
Pre-mod outstanding principal balance	\$939	\$3,509	\$187	\$252	\$14	\$1,854	\$144	-	\$6,898
Post-mod outstanding principal balance	\$939	\$3,482	\$187	\$252	\$14	\$1,748	\$144	-	\$6,765
Financial impact due to TDR taken as additional provision	\$169	\$(111)	\$27	-	\$11	\$37	-	-	\$133
Number that defaulted during the period	2	1	-	-	-	-	-	-	3
Recorded investment of TDRs that defaulted during the period	\$223	\$219	-	-	-	-	-	-	\$442
Financial impact due to the default of previous TDR taken as charge-offs or additional provisions	-	-	-	-	-	-	-	-	-

TDR Information for the Three Months Ended September 30, 2016										
(\$ in thousands)	RE Mortgage		Home Equity		Auto	Other	Construction		Total	
	Resid.	Comm.	Lines	Loans	Indirect	Consum.	C&I	Resid.		Comm.
Number	2	2	2	-	-	1	3	-	-	10
Pre-mod outstanding principal balance	\$318	\$170	\$113	-	-	\$8	\$65	-	-	\$674
Post-mod outstanding principal balance	\$324	\$170	\$114	-	-	\$8	\$66	-	-	\$682
Financial impact due to TDR taken as additional provision	\$6	-	-	-	-	-	\$15	-	-	\$21
Number that defaulted during the period	1	-	1	-	-	-	-	-	-	2
Recorded investment of TDRs that defaulted during the period	\$14	-	\$229	-	-	-	-	-	-	\$243
Financial impact due to the default of previous TDR taken as charge-offs or additional provisions	-	-	-	-	-	-	-	-	-	-

**Note 5 – Allowance for Loan Losses (continued)**

The following tables show certain information regarding TDRs that occurred during the periods indicated:

(\$ in thousands)	TDR Information for the Nine Months Ended September 30, 2016									
	RE Mortgage		Home Equity		Auto	Other	C&I	Construction		Total
	Resid.	Comm.	Lines	Loans	Indirect	Consum.		Resid.	Comm.	
Number	3	3	9	3	-	2	4	-	-	24
Pre-mod outstanding principal balance	\$650	\$248	\$707	\$280	-	\$27	\$77	-	-	\$1,989
Post-mod outstanding principal balance	\$656	\$249	\$709	\$317	-	\$27	\$77	-	-	\$2,035
Financial impact due to TDR taken as additional provision	\$50	-	\$205	\$46	-	\$2	\$23	-	-	\$326
Number that defaulted during the period	2	-	1	-	-	-	-	-	-	3
Recorded investment of TDRs that defaulted during the period	\$101	-	\$229	-	-	-	-	-	-	\$330
Financial impact due to the default of previous TDR taken as charge-offs or additional provisions	-	-	-	-	-	-	-	-	-	-

Modifications classified as TDRs can include one or a combination of the following: rate modifications, term extensions, interest only modifications, either temporary or long-term, payment modifications, and collateral substitutions/additions.

For all new TDRs, an impairment analysis is conducted. If the loan is determined to be collateral dependent, any additional amount of impairment will be calculated based on the difference between estimated collectible value and the current carrying balance of the loan. This difference could result in an increased provision and is typically charged off. If the asset is determined not to be collateral dependent, the impairment is measured on the net present value difference between the expected cash flows of the restructured loan and the cash flows which would have been received under the original terms. The effect of this could result in a requirement for additional provision to the reserve. The effect of these required provisions for the period are indicated above.

Typically if a TDR defaults during the period, the loan is then considered collateral dependent and, if it was not already considered collateral dependent, an appropriate provision will be reserved or charge will be taken. The additional provisions required resulting from default of previously modified TDR's are noted above.

**Note 6 – Foreclosed Assets**

A summary of the activity in the balance of foreclosed assets follows (in thousands):

	Nine months ended September 30, 2017			Nine months ended September 30, 2016		
	Noncovered	Covered	Total	Noncovered	Covered	Total
Beginning balance, net	\$3,763	\$223	\$3,986	\$5,369	-	\$5,369
Additions/transfers from loans	726	-	726	1,730	\$223	1,953
Dispositions/sales	(1,256)	(223)	(1,479)	(3,157)	-	(3,157)
Valuation adjustments	(162)	-	(162)	(41)	-	(41)
Ending balance, net	\$3,701	-	\$3,071	\$3,901	\$223	\$4,124
Ending valuation allowance	\$(248)	-	\$(248)	\$(241)	-	\$(241)
Ending number of foreclosed assets	11	-	11	14	1	15
Proceeds from sale of foreclosed assets	\$1,571	\$216	\$1,787	\$3,375	-	\$3,375
Gain (loss) on sale of foreclosed assets	\$315	(7)	\$308	\$218	-	\$218

As of September 30, 2017, \$1,386,000 of foreclosed residential real estate properties, all of which the Company has obtained physical possession of, are included in foreclosed assets. At September 30, 2017, the recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are underway is \$340,000.

**Note 7 - Premises and Equipment**

Premises and equipment were comprised of:

	September 30, 2017	December 31, 2016
	(In thousands)	
Land & land improvements	\$10,021	\$9,522
Buildings	43,860	42,345
Furniture and equipment	34,530	31,428
	<u>88,411</u>	<u>83,295</u>
Less: Accumulated depreciation	(39,892)	(37,412)
	48,519	45,883
Construction in progress	6,476	2,523
Total premises and equipment	<u>\$54,995</u>	<u>\$48,406</u>

Depreciation expense for premises and equipment amounted to \$1,520,000 and \$1,316,000 for the three months ended September 30, 2017 and 2016, respectively. Depreciation expense for premises and equipment amounted to \$4,224,000 and \$4,002,000 for the nine months ended September 30, 2017 and 2016, respectively. During the three months ended September 31, 2016, the Company determined to sell a former bank branch property with net book value of \$1,934,000, wrote the property down by \$716,000 to its estimated market value of \$1,218,000, and classified the property as held for sale. The property was subsequently sold during the three months ended September 30, 2016 without gain or further loss.

**Note 8 – Cash Value of Life Insurance**

A summary of the activity in the balance of cash value of life insurance follows (in thousands):

	Nine months ended September 30,	
	2017	2016
Beginning balance	\$95,912	\$94,560
Increase in cash value of life insurance	2,043	2,086
Death benefit receivable in excess of cash value	108	238
Death benefit receivable	(921)	(1,603)
Ending balance	<u>\$97,142</u>	<u>\$95,281</u>
End of period death benefit	\$165,006	\$166,623
Number of policies owned	183	187
Insurance companies used	14	14
Current and former employees and directors covered	57	58

As of September 30, 2017, the Bank was the owner and beneficiary of 183 life insurance policies, issued by 14 life insurance companies, covering 57 current and former employees and directors. These life insurance policies are recorded on the Company's financial statements at their reported cash (surrender) values. As a result of current tax law and the nature of these policies, the Bank records any increase in cash value of these policies as nontaxable noninterest income. If the Bank decided to surrender any of the policies prior to the death of the insured, such surrender may result in a tax expense related to the life-to-date cumulative increase in cash value of the policy. If the Bank retains such policies until the death of the insured, the Bank would receive nontaxable proceeds from the insurance company equal to the death benefit of the policies. The Bank has entered into Joint Beneficiary Agreements (JBAs) with certain of the insured that for certain of the policies provide some level of sharing of the death benefit, less the cash surrender value, among the Bank and the beneficiaries of the insured upon the receipt of death benefits. See Note 15 of these condensed consolidated financial statements for additional information on JBAs.

**Note 9 - Goodwill and Other Intangible Assets**

The following table summarizes the Company's goodwill intangible as of the dates indicated:

	September 30,		December 31,	
(dollar in thousands)	2017	Additions	Reductions	2016
Goodwill	<u>\$64,311</u>	-	-	<u>\$64,311</u>

The following table summarizes the Company's core deposit intangibles as of the dates indicated:

	September 30,		Fully		December 31,	
(dollar in thousands)	2017	Additions	Reductions/ Amortization	Depreciated	2016	
Core deposit intangibles	\$9,558	-	-	\$(562)	\$10,120	
Accumulated amortization	(4,045)	-	\$(1,050)	\$562	(3,557)	
Core deposit intangibles, net	<u>\$5,513</u>	-	<u>\$(1,050)</u>	-	<u>\$6,563</u>	

The Company recorded additions to its CDI of \$2,046,000 in conjunction with the acquisition of three branch offices from Bank of America on March 18, 2016, \$6,614,000 in conjunction with the North Valley Bancorp acquisition on October 3, 2014, \$898,000 in conjunction with the Citizens acquisition on September 23, 2011, and \$562,000 in conjunction with the Granite acquisition on May 28, 2010.

The following table summarizes the Company's remaining estimated core deposit intangible amortization (dollars in thousands):

<u>Periods Ended</u>	<u>Estimated Core Deposit Intangible Amortization</u>
2017	\$339
2018	1,324
2019	1,228
2020	1,228
2021	969
Thereafter	425

**Note 10 - Mortgage Servicing Rights**

The following tables summarize the activity in, and the main assumptions used to determine the fair value of mortgage servicing rights ("MSRs") for the periods indicated (dollars in thousands):

	<u>Three months ended September 30,</u>		<u>Nine months ended September 30,</u>	
	2017	2016	2017	2016
Mortgage servicing rights:				
Balance at beginning of period	\$6,596	\$6,720	\$6,595	\$7,618
Additions	147	287	619	788
Change in fair value	(324)	(799)	(795)	(2,198)
Balance at end of period	<u>\$6,419</u>	<u>\$6,208</u>	<u>\$6,419</u>	<u>\$6,208</u>
Servicing, late and ancillary fees received	\$513	\$480	\$1,560	\$1,513
Balance of loans serviced at:				
Beginning of period	\$822,549	\$814,702	\$816,623	\$817,917
End of period	\$812,005	\$811,128	\$812,005	\$811,128
Period end:				
Weighted-average prepayment speed (CPR)			9.2%	12.8%
Discount rate			14.0%	12.0%

The changes in fair value of MSRs that occurred during the three and nine months ended September 30, 2017 and 2016 were mainly due to changes in principal balances, changes in mortgage prepayment speeds, and changes in investor required rate of return, or discount rate, of the MSRs

**Note 11 - Indemnification Asset**

A summary of the activity in the balance of indemnification asset (liability) follows (in thousands):

	<u>Three months ended September 30,</u>		<u>Nine months ended September 30,</u>	
	2017	2016	2017	2016
Beginning (payable) receivable balance	-	\$(662)	\$(744)	\$(521)
Effect of actual covered losses and change in estimated future covered losses	-	17	(224)	(245)
Reimbursable expenses (revenue), net	-	-	256	(4)
Payments made (received)	-	107	-	232
Gain on termination of loss share agreement	-	-	712	-
Ending (payable) receivable balance	<u>-</u>	<u>\$(538)</u>	<u>-</u>	<u>\$(538)</u>
Amount of indemnification asset recorded in other assets			-	\$95
Amount of indemnification liability recorded in other liabilities			-	(633)
Ending balance			<u>-</u>	<u>\$(538)</u>

During May 2015, the indemnification portion of the Company's agreement with the FDIC related to the Company's acquisition of certain nonresidential real estate loans of Granite in May 2010 expired. The indemnification portion of the Company's agreement with the FDIC related to the Company's acquisition of certain residential real estate loans of Granite in May 2010 was set to expire in May 2018. The agreement specified that recoveries of losses that are claimed by the Company and indemnified by the FDIC under the agreement that are recovered by the Company through May 2020 are to be shared with the FDIC in the same proportion as they were indemnified by the FDIC. In addition, the agreement specified that at the end of the agreement in May 2020, to the extent that total claimed losses plus servicing expenses, net of recoveries, claimed under the agreement over the entire ten year period of the agreement did not meet a certain threshold, the Company would have been required to pay to the FDIC a "true up" amount equal to fifty percent of the difference of the threshold and actual claimed losses plus servicing expenses, net of recoveries. On May 9, 2017, the Company and the FDIC terminated their loss sharing agreements. As part of the termination agreement, the Company paid the FDIC \$184,000, and recorded a \$712,000 gain representing the difference between the Company's payment to the FDIC and the recorded payable balance on May 9, 2017.

**Note 12 – Other Assets**

Other assets were comprised of (in thousands):

	September 30, 2017	December 31, 2016
Deferred tax asset, net	\$33,091	\$36,199
Prepaid expense	3,912	3,045
Software	1,563	2,039
Advanced compensation	-	249
Capital Trusts	1,706	1,702
Investment in Low Housing Tax Credit Funds	17,453	18,465
Life insurance proceeds receivable	2,242	2,120
Tax refund receivable	-	6,460
Premises held for sale	-	2,896
Due from broker	25,757	-
Miscellaneous other assets	1,212	1,568
Total other assets	<u>\$86,936</u>	<u>\$74,743</u>

**Note 13 - Deposits**

A summary of the balances of deposits follows (in thousands):

	September 30 2017	December 31, 2016
Noninterest-bearing demand	\$1,283,949	\$1,275,745
Interest-bearing demand	965,480	887,625
Savings	1,367,597	1,397,036
Time certificates, over \$250,000	74,944	75,184
Other time certificates	235,486	259,970
Total deposits	<u>\$3,927,456</u>	<u>\$3,895,560</u>

Certificate of deposit balances of \$50,000,000 from the State of California were included in time certificates, \$250,000 and over, at each of September 30, 2017 and December 31, 2016. 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 credit worthiness constraints. Overdrawn deposit balances of \$1,219,000 and \$1,191,000 were classified as consumer loans at September 30, 2017 and December 31, 2016, respectively.

**Note 14 – Reserve for Unfunded Commitments**

The following tables summarize the activity in reserve for unfunded commitments for the periods indicated (dollars in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Balance at beginning of period	\$2,599	\$2,883	\$2,719	\$2,475
Provision for losses – unfunded commitments	390	25	270	433
Balance at end of period	<u>\$2,989</u>	<u>\$2,908</u>	<u>\$2,989</u>	<u>\$2,908</u>

**Note 15 – Other Liabilities**

Other liabilities were comprised of (in thousands):

	September 30, 2017	December 31, 2016
Deferred compensation	\$6,431	\$6,525
Pension liability	27,238	26,645
Joint beneficiary agreements	3,192	3,007
Low income housing tax credit fund commitments	11,439	15,176
Accrued salaries and benefits expense	6,176	5,704
Loan escrow and servicing payable	2,264	2,146
Deferred Revenue	1,759	726
Litigation contingency	1,450	1,450
Miscellaneous other liabilities	2,901	5,985
Total other liabilities	<u>\$62,850</u>	<u>\$67,364</u>

**Note 16 - Other Borrowings**

A summary of the balances of other borrowings follows:

	September 30, 2017	December 31, 2016
	(in thousands)	
FHLB collateralized borrowing, fixed rate, as of September 30, 2017 of 1.11%, payable on October 2, 2017	\$85,737	-
Other collateralized borrowings, fixed rate, as of September 30, 2017 of 0.05%, payable on October 2, 2017	12,993	\$17,493
Total other borrowings	<u>\$98,730</u>	<u>\$17,493</u>

The Company did not enter into any repurchase agreements during the nine months ended September 30, 2017 or the year ended December 31, 2016.

The Company maintains a collateralized line of credit with the Federal Home Loan Bank of San Francisco. Based on the FHLB stock requirements at September 30, 2017, this line provided for maximum borrowings of \$1,303,462,000 of which \$85,737,000 was outstanding as of September 30, 2017, leaving \$1,217,725,000 available. As of September 30, 2017, the Company has designated investment securities with fair value of \$70,534,000 and loans totaling \$1,919,515,000 as potential collateral under this collateralized line of credit with the FHLB.

The Company had \$12,993,000 and \$17,493,000 of other collateralized borrowings at September 30, 2017 and December 31, 2016, respectively. Other collateralized borrowings are generally overnight maturity borrowings from non-financial institutions that are collateralized by securities owned by the Company. As of September 30, 2017, the Company has pledged as collateral and sold under agreements to repurchase investment securities with fair value of \$27,150,000 under these other collateralized borrowings.

The Company maintains a collateralized line of credit with the San Francisco Federal Reserve Bank. As of September 30, 2017, this line provided for maximum borrowings of \$130,985,000 of which none was outstanding, leaving \$130,985,000 available. As of September 30, 2017, the Company has designated investment securities with fair value of \$18,000 and loans totaling \$232,290,000 as potential collateral under this collateralized line of credit with the San Francisco Federal Reserve Bank.

The Company had available unused correspondent banking lines of credit from commercial banks totaling \$20,000,000 for federal funds transactions at September 30, 2017.

#### Note 17 – Junior Subordinated Debt

At September 30, 2017, the Company had five wholly-owned subsidiary business trusts that had issued \$62.9 million of trust preferred securities (the “Capital Trusts”). Trust preferred securities accrue and pay distributions periodically at specified annual rates as provided in the indentures. The trusts used the net proceeds from the offering to purchase a like amount of subordinated debentures (the “Debentures”) of the Company. The Debentures are the sole assets of the trusts. The Company’s obligations under the subordinated debentures and related documents, taken together, constitute a full and unconditional guarantee by the Company of the obligations of the trusts. The trust preferred securities are mandatorily redeemable upon the maturity of the Debentures, or upon earlier redemption as provided in the indentures. The Company has the right to redeem the Debentures in whole (but not in part) on or after specific dates, at a redemption price specified in the indentures plus any accrued but unpaid interest to the redemption date. The Company also has a right to defer consecutive payments of interest on the debentures for up to five years.

The Company organized two of the Capital Trusts. The Company acquired its three other Capital Trusts and assumed their related Debentures as a result of its acquisition of North Valley Bancorp. At the acquisition date of October 3, 2014, the Debentures associated with North Valley Bancorp’s three Capital Trusts were recorded on the Company’s books at their fair values of \$5,006,000, \$3,918,000, and \$6,063,000, respectively. The related fair value discounts to face value of these Debentures will be amortized over the remaining time to maturity for each of these Debentures using the effective interest method. Similar, and proportional, discounts were applied to the acquired common stock interests in each of the acquired Capital Trusts and these discounts will be proportionally amortized over the remaining time to maturity for each related debenture.

The recorded book values of the Debentures issued by the Capital Trusts are reflected as junior subordinated debt in the Company’s consolidated balance sheets. The common stock issued by the Capital Trusts and owned by the Company is recorded in other assets in the Company’s consolidated balance sheets. The recorded book value of the debentures issued by the Capital Trusts, less the recorded book value of the common stock of the Capital Trusts owned by the Company, continues to qualify as Tier 1 or Tier 2 capital under interim guidance issued by the Board of Governors of the Federal Reserve System.

The following table summarizes the terms and recorded balance of each subordinated debenture as of the date indicated (dollars in thousands):

Subordinated Debt Series	Maturity Date	Face Value	Coupon Rate (Variable) 3 mo. LIBOR +	As of September 30, 2017		December 31, 2016
				Current Coupon Rate	Recorded Book Value	Recorded Book Value
TriCo Cap Trust I	10/7/2033	\$20,619	3.05%	4.35%	\$20,619	\$20,619
TriCo Cap Trust II	7/23/2034	20,619	2.55%	3.86%	20,619	20,619
North Valley Trust II	4/24/2033	6,186	3.25%	4.56%	5,125	5,095
North Valley Trust III	4/24/2034	5,155	2.80%	4.11%	4,032	4,005
North Valley Trust IV	3/15/2036	10,310	1.33%	2.65%	6,415	6,329
		<u>\$62,889</u>			<u>\$56,810</u>	<u>\$56,667</u>

During the nine months ended September 30, 2017, the balance of Junior Subordinated Debt increased \$143,000 to \$56,810,000 due to purchase fair value discount amortization.



## Note 18 - Commitments and Contingencies

*Restricted Cash Balances*— Reserves (in the form of deposits with the San Francisco Federal Reserve Bank) of \$79,226,000 and \$78,183,000 were maintained to satisfy Federal regulatory requirements at September 30, 2017 and December 31, 2016. These reserves are included in cash and due from banks in the accompanying consolidated balance sheets.

*Lease Commitments*— The Company leases 42 sites under non-cancelable operating leases. The leases contain various provisions for increases in rental rates, based either on changes in the published Consumer Price Index or a predetermined escalation schedule. Substantially all of the leases provide the Company with the option to extend the lease term one or more times following expiration of the initial term. The Company currently does not have any capital leases.

At December 31, 2016, future minimum commitments under non-cancelable operating leases with initial or remaining terms of one year or more are as follows:

	<u>Operating Leases</u> (in thousands)
2017	\$3,320
2018	2,523
2019	1,924
2020	1,325
2021	963
Thereafter	1,696
Future minimum lease payments	<u>\$11,751</u>

Rent expense under operating leases was \$1,038,000 and \$1,034,000 during the three months ended September 30, 2017 and 2016, respectively. Rent expense was offset by rent income of \$10,000 and \$58,000 during the three months ended September 30, 2017 and 2016, respectively. Rent expense under operating leases was \$3,134,000 and \$3,024,000 during the nine months ended September 30, 2017 and 2016, respectively. Rent expense was offset by rent income of \$34,000 and \$177,000 during the nine months ended September 30, 2017 and 2016, respectively.

*Financial Instruments with Off-Balance-Sheet Risk*— The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit, and deposit account overdraft privilege. Those instruments involve, to varying degrees, elements of risk in excess of the amount recognized in the balance sheet. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit written is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The Company's exposure to loss in the event of nonperformance by the other party to the financial instrument for deposit account overdraft privilege is represented by the overdraft privilege amount disclosed to the deposit account holder. The following table presents a summary of the Bank's commitments and contingent liabilities:

(in thousands)	September 30,	December 31,
	2017	2016
Financial instruments whose amounts represent risk:		
Commitments to extend credit:		
Commercial loans	\$253,673	\$220,836
Consumer loans	422,521	406,855
Real estate mortgage loans	63,290	42,184
Real estate construction loans	170,416	97,399
Standby letters of credit	12,700	12,763
Deposit account overdraft privilege	96,650	98,583

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates of one year or less or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on Management's credit evaluation of the customer. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, residential properties, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. Most standby letters of credit are issued for one year or less. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral requirements vary, but in general follow the requirements for other loan facilities.

Deposit account overdraft privilege amount represents the unused overdraft privilege balance available to the Company's deposit account holders who have deposit accounts covered by an overdraft privilege. The Company has established an overdraft privilege for certain of its deposit account products whereby all holders of such accounts who bring their accounts to a positive balance at least once every thirty days

receive the overdraft privilege. The overdraft privilege allows depositors to overdraft their deposit account up to a predetermined level. The predetermined overdraft limit is set by the Company based on account type.

*Legal Proceedings* — On September 15, 2014, a former Personal Banker at one of the Bank's in-store branches filed a Class Action Complaint against the Bank in Butte County Superior Court, alleging causes of action related to the observance of meal and rest periods and seeking to represent a class of current and former branch employees with the same or similar job duties, employed by the Bank within the State of California during the preceding four years. On or about June 25, 2015, Plaintiff filed an Amended Complaint expanding the class definition to include all current and former non-exempt branch employees employed by the Bank within the State of California at any time during the period of September 15, 2010 to the entry of judgment. The Bank responded to the First Amended Complaint by denying the charges and the parties engaged in written discovery. The parties then engaged in non-binding mediation during the third quarter of 2016.

In addition to this, on January 20, 2015, a then-current Personal Banker at one of the Bank's in-store branches filed a First Amended Complaint against the Bank and the Company in Sacramento County Superior Court, alleging causes of action related to wage statement violations. As part of the Complaint Plaintiff is seeking to represent a class of current and former exempt and non-exempt employees who worked for the Company and/or the Bank during the time period of December 12, 2013 to the date of filing the action. The Company and the Bank responded to the First Amended Complaint by denying the charges and engaging in written discovery with Plaintiff. The parties then engaged in non-binding mediation of the action during the third quarter of 2016 as well. This matter was transferred to the Butte County Superior Court and consolidated with the case above, effective August 25, 2017.

As part of the mediations, which took place concurrently, the Bank agreed in principal to settle the two matters in a consolidated settlement proceeding. In connection with the settlement and in consideration of a full release of all claims raised in both the actions, the Bank has agreed to pay up to \$1.9 million though the actual cost of the settlement will depend on the number of claims submitted by the members of the purported classes. As a result, the Bank estimates the actual cost of the settlement may be approximately \$1,450,000, and recorded such estimate. The settlement agreement was preliminarily approved and has been executed, although final settlement is subject to customary conditions, including court approval following notice to the members of the purported classes. It should be noted there are no assurances the court will approve the final settlement.

Neither the Company nor its subsidiaries are a party to any other pending legal proceedings that are material, nor is their property the subject of any other material pending legal proceeding at this time. All other legal proceedings are routine and arise out of the ordinary course of the Bank's business. None of those proceedings are currently expected to have a material adverse impact upon the Company's and the Bank's business, their consolidated financial position nor their operations in any material amount not already accrued, after taking into consideration any applicable insurance.

*Other Commitments and Contingencies*—The Company has entered into employment agreements or change of control agreements with certain officers of the Company providing severance payments and accelerated vesting of benefits under supplemental retirement agreements to the officers in the event of a change in control of the Company and termination for other than cause or after a substantial and material change in the officer's title, compensation or responsibilities.

The Bank owns 13,396 shares of Class B common stock of Visa Inc. which are convertible into Class A common stock at a conversion ratio of 1.648265 per Class B share. As of September 30, 2017, the value of the Class A shares was \$105.24 per share. Utilizing the conversion ratio, the value of unredeemed Class A equivalent shares owned by the Bank was \$2,324,000 as of September 30, 2017, 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.

Mortgage loans sold to investors may be sold with servicing rights retained, with only the standard legal representations and warranties regarding recourse to the Bank. Management believes that any liabilities that may result from such recourse provisions are not significant.

## **Note 19 – Shareholders' Equity**

### **Dividends Paid**

The Bank paid to the Company cash dividends in the aggregate amounts of \$5,185,000 and \$4,097,000 during the three months ended September 30, 2017 and 2016, respectively, and \$14,394,000 and \$11,434,000 during the nine months ended September 30, 2017 and 2016, respectively. The Bank is regulated by the Federal Deposit Insurance Corporation (FDIC) and the State of California Department of Business Oversight. Absent approval from the Commissioner of the Department of Business Oversight, California banking laws generally limit the Bank's ability to pay dividends to the lesser of (1) retained earnings or (2) net income for the last three fiscal years, less cash distributions paid during such period. Under this law, at December 31, 2016, the Bank could have paid dividends of \$82,615,000 to the Company without the approval of the Commissioner of the Department of Business Oversight.

### **Stock Repurchase Plan**

On August 21, 2007, the Board of Directors adopted a plan to repurchase, as conditions warrant, up to 500,000 shares of the Company's common stock on the open market. The timing of purchases and the exact number of shares to be purchased will depend on market conditions. The 500,000 shares authorized for repurchase under this stock repurchase plan represented approximately 3.2% of the Company's 15,814,662 outstanding common shares as of August 21, 2007. During the nine months ended September 30, 2017, and the year ended December 31, 2016, the Company repurchased no shares under this repurchase plan. This stock repurchase plan has no expiration date. As of September 30, 2017, the Company had repurchased 166,600 shares under this plan.

### Stock Repurchased Under Equity Compensation Plans

During the three months ended September, 2017 and 2016, employees tendered 21,738 and 4,129 shares, respectively, of the Company's common stock with market value of \$762,000, and \$108,000, respectively, in lieu of cash to exercise options to purchase shares of the Company's stock and to pay income taxes related to equity compensation plan instruments as permitted by the Company's shareholder-approved equity compensation plans.

During the nine months ended September 30, 2017 and 2016 employees tendered 107,390 and 101,125 shares, respectively, of the Company's common stock with market value of \$3,854,000 and \$2,774,000, respectively, in lieu of cash to exercise options to purchase shares of the Company's stock and to satisfy tax withholding requirements related to such exercises and the release of RSUs as permitted by the Company's shareholder-approved equity compensation plans.

The tendered shares were retired. The market value of tendered shares is the last market trade price at closing on the day an equity compensation plan instrument is exercised or released. Stock repurchased under equity incentive plans are not included in the total of stock repurchased under the stock repurchase plan announced on August 21, 2007.

### Note 20 - Stock Options and Other Equity-Based Incentive Instruments

In March 2009, the Company's Board of Directors adopted the TriCo Bancshares 2009 Equity Incentive Plan (2009 Plan) covering officers, employees, directors of, and consultants to, the Company. The 2009 Plan was approved by the Company's shareholders in May 2009. The 2009 Plan allows for the granting of the following types of "stock awards" (Awards): incentive stock options, nonstatutory stock options, performance awards, restricted stock, restricted stock unit (RSU) awards and stock appreciation rights. RSUs that vest based solely on the grantee remaining in the service of the Company for a certain amount of time, are referred to as "service condition vesting RSUs". RSUs that vest based on the grantee remaining in the service of the Company for a certain amount of time and a market condition such as the total return of the Company's common stock versus the total return of an index of bank stocks, are referred to as "market plus service condition vesting RSUs". In May 2013, the Company's shareholders approved an amendment to the 2009 Plan increasing the maximum aggregate number of shares of TriCo's common stock which may be issued pursuant to or subject to Awards from 650,000 to 1,650,000. The number of shares available for issuance under the 2009 Plan is reduced by: (i) one share for each share of common stock issued pursuant to a stock option or a Stock Appreciation Right and (ii) two shares for each share of common stock issued pursuant to a Performance Award, a Restricted Stock Award or a Restricted Stock Unit Award. When Awards made under the 2009 Plan expire or are forfeited or cancelled, the underlying shares will become available for future Awards under the 2009 Plan. To the extent that a share of common stock pursuant to an Award that counted as two shares against the number of shares again becomes available for issuance under the 2009 Plan, the number of shares of common stock available for issuance under the 2009 Plan shall increase by two shares. Shares awarded and delivered under the 2009 Plan may be authorized but unissued, or reacquired shares. As of September 30, 2017, 411,900 options for the purchase of common shares, and 123,479 restricted stock units were outstanding, and 527,651 shares remain available for issuance, under the 2009 Plan.

In May 2001, the Company adopted the TriCo Bancshares 2001 Stock Option Plan (2001 Plan) covering officers, employees, directors of, and consultants to, the Company. Under the 2001 Plan, the option exercise price cannot be less than the fair market value of the Common Stock at the date of grant except in the case of substitute options. Options for the 2001 Plan expire on the tenth anniversary of the grant date. Vesting schedules under the 2001 Plan are determined individually for each grant. As of September 30, 2017, 46,500 options for the purchase of common shares were outstanding under the 2001 Plan. As of May 2009, as a result of the shareholder approval of the 2009 Plan, no new options may be granted under the 2001 Plan.

Stock option activity during the nine months ended September 30, 2017 is summarized in the following table:

	Number of Shares	Option Price per Share	Weighted Average Exercise Price	Weighted Average Fair Value on Date of Grant
Outstanding at December 31, 2016	592,250	\$12.63 to \$23.21	\$17.12	
Options granted	-	- to -	-	-
Options exercised	(133,850)	\$14.54 to \$22.54	\$18.07	
Options forfeited	-	- to -	-	
Outstanding at September 30, 2017	458,400	\$12.63 to \$23.21	\$16.85	

The following table shows the number, weighted-average exercise price, intrinsic value, and weighted average remaining contractual life of options exercisable, options not yet exercisable and total options outstanding as of September 30, 2017:

	Currently Exercisable	Currently Not Exercisable	Total Outstanding
Number of options	431,100	27,300	458,400
Weighted average exercise price	\$16.61	\$20.54	\$16.85
Intrinsic value (in thousands)	\$10,406	\$552	\$10,958
Weighted average remaining contractual term (yrs.)	4.0	6.1	4.1

The 27,300 options that are currently not exercisable as of September 30, 2017 are expected to vest, on a weighted-average basis, over the next 1.1 years, and the Company is expected to recognize \$157,000 of pre-tax compensation costs related to these options as they vest. The Company did not modify any option grants during 2016 or the nine months ended September 30, 2017.

Restricted stock unit (RSU) activity is summarized in the following table for the dates indicated:

	Service Condition Vesting RSUs		Market Plus Service Condition Vesting RSUs	
	Number of RSUs	Weighted Average Fair Value on Date of Grant	Number of RSUs	Weighted Average Fair Value on Date of Grant
Outstanding at December 31, 2016	68,450		47,426	
RSUs granted	29,669	\$35.36	17,939	\$32.95
Additional market plus service condition RSUs vested			6,269	
RSUs added through dividend credits	939		-	
RSUs released	(28,397)		(18,805)	
RSUs forfeited/expired	(11)		-	
Outstanding at September 30, 2017	70,650		52,829	

The 70,650 of service condition vesting RSUs outstanding as of September 30, 2017 include a feature whereby each RSU outstanding is credited with a dividend amount equal to any common stock cash dividend declared and paid, and the credited amount is divided by the closing price of the Company's stock on the dividend payable date to arrive at an additional amount of RSUs outstanding under the original grant. The 70,650 of service condition vesting RSUs outstanding as of September 30, 2017 are expected to vest, and be released, on a weighted-average basis, over the next 1.5 years. The Company expects to recognize \$1,686,000 of pre-tax compensation costs related to these service condition vesting RSUs between September 30, 2017 and their vesting dates. The Company did not modify any service condition vesting RSUs during 2016 or the nine months ended September 30, 2017.

The 52,829 of market plus service condition vesting RSUs outstanding as of September 30, 2017 are expected to vest, and be released, on a weighted-average basis, over the next 1.6 years. The Company expects to recognize \$839,000 of pre-tax compensation costs related to these RSUs between September 30, 2017 and their vesting dates. As of September 30, 2017, the number of market plus service condition vesting RSUs outstanding that will actually vest, and be released, may be reduced to zero or increased to 79,243 depending on the total return of the Company's common stock versus the total return of an index of bank stocks from the grant date to the vesting date. The Company did not modify any market plus service condition vesting RSUs during 2016 or the nine months ended September 30, 2017.

#### Note 21 - Noninterest Income and Expense

The components of other noninterest income were as follows (in thousands):

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Service charges on deposit accounts	\$4,160	\$3,641	\$12,102	\$10,549
ATM and interchange fees	4,209	3,851	12,472	11,136
Other service fees	917	792	2,521	2,369
Mortgage banking service fees	514	537	1,561	1,570
Change in value of mortgage servicing rights	(325)	(799)	(795)	(2,198)
Total service charges and fees	9,475	8,022	27,861	23,426
Gain on sale of loans	606	953	2,293	2,645
Commissions on sale of non-deposit investment products	672	747	1,984	1,890
Increase in cash value of life insurance	732	709	2,043	2,086
Gain on sale of investment securities	961	-	961	-
Change in indemnification asset	-	(10)	490	(274)
Gain on sale of foreclosed assets	37	69	308	218
Sale of customer checks	89	110	287	299
Lease brokerage income	234	172	601	602
Loss on disposal of fixed assets	(33)	(13)	(61)	(52)
Life Insurance death benefit in excess of cash value	-	-	108	238
Other	157	307	668	1,023
Total other noninterest income	3,455	3,044	9,682	8,675
Total noninterest income	\$12,930	\$11,066	\$37,543	\$32,101
Mortgage loan servicing fees, net of change in fair value of mortgage loan servicing rights	\$189	\$(262)	\$766	\$(628)
Mortgage banking revenue	\$795	\$691	\$3,059	\$2,017

The components of noninterest expense were as follows (in thousands):

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Base salaries, net of deferred loan origination costs	\$13,600	\$13,419	\$40,647	\$39,095
Incentive compensation	2,609	2,798	6,980	7,008
Benefits and other compensation costs	4,724	4,643	14,693	14,067
Total salaries and benefits expense	20,933	20,860	62,320	60,170
Occupancy	2,799	2,667	8,196	7,504
Equipment	1,816	1,607	5,344	4,837
Data processing and software	2,495	2,068	7,332	6,266
ATM & POS network charges	1,425	1,915	3,353	3,923
Telecommunications	716	702	2,027	2,085
Postage	325	381	1,058	1,186
Courier service	235	280	752	816
Advertising	1,039	1,049	3,173	3,021
Assessments	427	654	1,252	1,864
Operational losses	301	497	1,166	1,006
Professional fees	901	1,018	2,357	3,183
Foreclosed assets expense	41	37	117	197
Provision for foreclosed asset losses	134	8	162	40
Change in reserve for unfunded commitments	390	25	270	433
Intangible amortization	339	359	1,050	1,017
Merger expense	-	-	-	784
Litigation contingent liability	-	-	-	1,450
Other	2,906	3,289	9,019	9,652
Total other noninterest expense	16,289	16,556	46,628	49,264
Total noninterest expense	\$37,222	\$37,416	\$108,948	\$109,434
Merger expense:				
Base salaries (outside temporary help)	-	-	-	\$187
Equipment	-	-	-	35
Professional fees	-	-	-	342
Advertising and marketing	-	-	-	114
Other	-	-	-	106
Total merger expense	-	-	-	\$784
Average full time equivalent staff	993	1,022	1,005	996
Noninterest expense to revenue (FTE)	64.6%	69.4%	64.5%	69.0%

**Note 22 - Income Taxes**

The provisions for income taxes applicable to income before taxes differ from amounts computed by applying the statutory Federal income tax rates to income before taxes. The effective tax rate and the statutory federal income tax rate are reconciled for the periods indicated as follows:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Federal statutory income tax rate	35.0%	35.0%	35.0%	35.0%
State income taxes, net of federal tax benefit	6.9	6.9	6.8	6.7
Tax-exempt interest on municipal obligations	(1.9)	(1.7)	(1.8)	(1.9)
Increase in cash value of insurance policies	(1.3)	(1.2)	(1.3)	(1.6)
Low income housing tax credits	(0.5)	(0.3)	(0.4)	(0.3)
Equity compensation	(0.8)	-	(1.4)	-
Other	0.1	-	0.2	0.1
Effective Tax Rate	37.5%	38.7%	37.1%	38.0%

**Note 23 – Earnings Per Share**

Basic earnings per share represent income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustments to income that would result from assumed issuance. Potential common shares that may be issued by the Company relate solely from outstanding stock options, and are determined using the treasury stock method. Earnings per share have been computed based on the following:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Net income	\$11,897	\$12,199	\$37,565	\$32,278
Average number of common shares outstanding	22,932	22,825	22,901	22,804
Effect of dilutive stock options and restricted stock units	312	274	338	273
Average number of common shares outstanding used to calculate diluted earnings per share	23,244	23,099	23,239	23,077
Options excluded from diluted earnings per share because the effect of these options was antidilutive	-	12	-	18

**Note 24 – Comprehensive Income**

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

The components of accumulated other comprehensive income, included in shareholders' equity, are as follows:

	September 30, 2017	December 31, 2016
	(in thousands)	
Net unrealized loss on available for sale securities	\$(3,459)	\$(8,870)
Tax effect	1,455	3,729
Unrealized holding loss on available for sale securities, net of tax	(2,004)	(5,141)
Unfunded status of the supplemental retirement plans	(4,431)	(4,714)
Tax effect	1,863	1,982
Unfunded status of the supplemental retirement plans, net of tax	(2,568)	(2,732)
Joint beneficiary agreement liability	(40)	(40)
Tax effect	-	-
Joint beneficiary agreement liability, net of tax	(40)	(40)
Accumulated other comprehensive loss	\$(4,612)	\$(7,913)

The components of other comprehensive income and related tax effects are as follows:

(in thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Unrealized holding gains (losses) on available for sale securities before reclassifications	\$674	\$(2,058)	\$6,372	\$11,240
Amounts reclassified out of accumulated other comprehensive income	(961)	-	(961)	-
Unrealized holding (losses) gains on available for sale securities after reclassifications	(287)	(2,058)	5,411	11,240
Tax effect	121	865	(2,274)	(4,726)
Unrealized holding (losses) gains on available for sale securities, net of tax	(166)	(1,193)	3,137	\$6,514
Change in unfunded status of the supplemental retirement plans before reclassifications	-	-	-	-
Amounts reclassified out of accumulated other comprehensive income:				
Amortization of prior service cost	(1)	(10)	(5)	(30)
Amortization of actuarial losses	96	138	288	413
Total amounts reclassified out of accumulated other comprehensive income	95	128	283	383
Change in unfunded status of the supplemental retirement plans after reclassifications	95	128	283	383
Tax effect	(40)	(54)	(119)	(161)
Change in unfunded status of the supplemental retirement plans, net of tax	55	74	164	222
Change in joint beneficiary agreement liability before reclassifications	-	(1)	-	(5)
Amounts reclassified out of accumulated other comprehensive income	-	-	-	-
Change in joint beneficiary agreement liability after reclassifications	-	(1)	-	(5)
Tax effect	-	-	-	-
Change in joint beneficiary agreement liability, net of tax	-	(1)	-	(5)
Total other comprehensive (loss) income	\$(111)	\$(1,120)	\$3,301	\$6,731

## Note 25 - Retirement Plans

### 401(k) Plan

The Company sponsors a 401(k) Plan whereby substantially all employees age 21 and over with 90 days of service may participate. Participants may contribute a portion of their compensation subject to certain limits based on federal tax laws. Prior to July 1, 2015, the Company did not contribute to the 401(k) Plan. Effective July 1, 2015, the Company initiated a discretionary matching contribution equal to 50% of participant's elective deferrals each quarter, up to 4% of eligible compensation. The following table sets forth the benefit expense attributable to the 401(k) Plan matching contributions, and the contributions made by the Company to the 401(k) Plan during the periods indicated:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
401(k) Plan benefits expense	\$164	\$187	\$603	\$515
401(k) Plan contributions made by the Company	\$224	\$187	\$595	\$648

### Employee Stock Ownership Plan

Substantially all employees with at least one year of service are covered by a discretionary employee stock ownership plan (ESOP). Contributions are made to the plan at the discretion of the Board of Directors. Company shares owned by the ESOP are paid dividends and included in the calculation of earnings per share exactly as other common shares outstanding. The following table sets forth the benefit expense attributable to the ESOP, and the contributions made by the Company to the ESOP during the periods indicated:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
ESOP benefits expense	\$537	\$463	\$1,610	\$1,368
ESOP contributions made by the Company	\$537	-	\$2,073	\$905

### Deferred Compensation Plans

The Company has deferred compensation plans for certain directors and key executives, which allow certain directors and key executives designated by the Board of Directors of the Company to defer a portion of their compensation. The Company has purchased insurance on the lives of the participants and intends to hold these policies until death as a cost recovery of the Company's deferred compensation obligations of \$6,431,000 and \$6,525,000 at September 30, 2017 and December 31, 2016, respectively. The following table sets forth the earnings credits on deferred balances included in noninterest expense during the periods indicated:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Deferred compensation earnings credits included in noninterest expense	\$111	\$111	\$365	\$366

### Supplemental Retirement Plans

The Company has supplemental retirement plans for current and former directors and key executives. These plans are non-qualified defined benefit plans and are unsecured and unfunded. The Company has purchased insurance on the lives of the participants and intends (but is not required) to use the cash values of these policies to pay the retirement obligations. The following table sets forth the net periodic benefit cost recognized for the plans:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Net pension cost included the following components:	\$235	\$260	\$706	\$781
Service cost-benefits earned during the period	248	256	743	769
Interest cost on projected benefit obligation	-	1	1	1
Amortization of net obligation at transition	(3)	(10)	(8)	(30)
Amortization of prior service cost	98	137	292	412
Recognized net actuarial loss	\$578	\$644	\$1,734	\$1,933
Net periodic pension cost				
Company contributions to pension plans	\$267	\$260	\$856	\$834
Pension plan payouts to participants	\$267	\$260	\$856	\$834

For the year ending December 31, 2017, the Company expects to contribute and pay out as benefits \$1,117,000 to participants under the plans.

### Note 26 - Related Party Transactions

Certain directors, officers, and companies with which they are associated were customers of, and had banking transactions with, the Company or the Bank in the ordinary course of business.

The following table summarizes the activity in these loans for periods indicated (in thousands):

Balance December 31, 2015	\$4,201
Advances/new loans	730
Removed/payments	(2,499)
Balance December 31, 2016	2,432
Advances/new loans	160
Removed/payments	(666)
Balance September 30, 2017	\$1,926

### Note 27 - Fair Value Measurement

The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In estimating fair value, the Company utilizes valuation techniques that are consistent with the market approach, income approach, and/or the cost approach. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability including assumptions about the risk inherent in a particular valuation technique, the effect of a restriction on the sale or use of an asset and the risk of nonperformance. Securities available-for-sale and mortgage servicing rights are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as loans held for sale, loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or impairment write-downs of individual assets.



The Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the observable nature of the assumptions used to determine fair value. These levels are:

- Level 1 - Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2 - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 - Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

*Securities available for sale* - Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. The Company had no securities classified as Level 3 during any of the periods covered in these financial statements.

*Loans held for sale* - Loans held for sale are carried at the lower of cost or fair value. The fair value of loans held for sale is based on what secondary markets are currently offering for loans with similar characteristics. As such, we classify those loans subjected to nonrecurring fair value adjustments as Level 2.

*Impaired originated and PNCI loans* - Originated and PNCI loans are not recorded at fair value on a recurring basis. However, from time to time, an originated or PNCI loan is considered impaired and an allowance for loan losses is established. Originated and PNCI loans for which it is probable that payment of interest and principal will not be made in accordance with the original contractual terms of the loan agreement are considered impaired. The fair value of an impaired originated or PNCI loan is estimated using one of several methods, including collateral value, fair value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired originated and PNCI loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. Impaired originated and PNCI loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value which uses substantially observable data, the Company records the impaired originated or PNCI loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value, or the appraised value contains a significant unobservable assumption, such as deviations from comparable sales, and there is no observable market price, the Company records the impaired originated or PNCI loan as nonrecurring Level 3.

*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 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. When the fair value of foreclosed assets is based on an observable market price or a current appraised value which uses substantially observable data, the Company records the impaired originated loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value, or the appraised value contains a significant unobservable assumption, such as deviations from comparable sales, and there is no observable market price, the Company records the foreclosed asset as nonrecurring Level 3. Revenue and expenses from operations and changes in the valuation allowance are included in other noninterest expense.

*Mortgage servicing rights* - Mortgage servicing rights are carried at fair value. A valuation model, which utilizes a discounted cash flow analysis using a discount rate and prepayment speed assumptions is used in the computation of the fair value measurement. While the prepayment speed assumption is currently quoted for comparable instruments, the discount rate assumption currently requires a significant degree of management judgment and is therefore considered an unobservable input. As such, the Company classifies mortgage servicing rights subjected to recurring fair value adjustments as Level 3. Additional information regarding mortgage servicing rights can be found in Note 10 in the consolidated financial statements at Item 1 of this report.

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis (in thousands):

Fair value at September 30, 2017	Total	Level 1	Level 2	Level 3
Securities available for sale:				
Obligations of U.S. government corporations and agencies	\$554,062	-	\$554,062	-
Obligations of states and political subdivisions	121,217	-	121,217	-
Marketable equity services	2,957	\$2,957	-	-
Mortgage servicing rights	6,419	-	-	\$6,419
Total assets measured at fair value	<u>\$684,655</u>	<u>\$2,957</u>	<u>\$675,279</u>	<u>\$6,419</u>
Fair value at December 31, 2016	Total	Level 1	Level 2	Level 3
Securities available-for-sale:				
Obligations of U.S. government corporations and agencies	\$429,678	-	\$429,678	-
Obligations of states and political subdivisions	117,617	-	117,617	-
Marketable equity securities	2,938	\$2,938	-	-
Mortgage servicing rights	6,595	-	-	\$6,595
Total assets measured at fair value	<u>\$556,828</u>	<u>\$2,938</u>	<u>\$547,295</u>	<u>\$6,595</u>

Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally corresponds with the Company's quarterly valuation process. There were no transfers between any levels during the six months ended September 30, 2017 or the year ended December 31, 2016.

The following table provides a reconciliation of assets and liabilities measured at fair value using significant unobservable inputs (Level 3) on a recurring basis during the time periods indicated. Had there been any transfer into or out of Level 3 during the time periods indicated, the amount included in the "Transfers into (out of) Level 3" column would represent the beginning balance of an item in the period (interim quarter) during which it was transferred (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Mortgage servicing rights:				
Balance at beginning of period	\$6,596	\$6,720	\$6,595	\$7,618
Additions	147	287	619	788
Change in fair value	(324)	(799)	(795)	(2,198)
Balance at end of period	<u>\$6,419</u>	<u>\$6,208</u>	<u>\$6,419</u>	<u>\$6,208</u>

The Company's method for determining the fair value of mortgage servicing rights is described in Note 1. The key unobservable inputs used in determining the fair value of mortgage servicing rights are mortgage prepayment speeds and the discount rate used to discount cash projected cash flows. Generally, any significant increases in the mortgage prepayment speed and discount rate utilized in the fair value measurement of the mortgage servicing rights will result in a negative fair value adjustments (and decrease in the fair value measurement). Conversely, a decrease in the mortgage prepayment speed and discount rate will result in a positive fair value adjustment (and increase in the fair value measurement). Note 10 contains additional information regarding mortgage servicing rights.

The following table presents quantitative information about recurring Level 3 fair value measurements at September 30, 2017:

	Fair Value (in thousands)	Valuation Technique	Unobservable Inputs	Range, Weighted Average
Mortgage Servicing Rights	\$6,419	Discounted cash flow	Constant prepayment rate Discount rate	6.5%-21.4%, 9.2% 14.0%-16.0%, 14.0%

The following table presents quantitative information about recurring Level 3 fair value measurements at December 31, 2016:

	Fair Value (in thousands)	Valuation Technique	Unobservable Inputs	Range, Weighted Average
Mortgage Servicing Rights	\$6,595	Discounted cash flow	Constant prepayment rate Discount rate	6.9%-16.6%, 8.8% 14.0%-16.0%, 14.0%

The tables below present the recorded investment in assets and liabilities measured at fair value on a nonrecurring basis, as of the dates indicated (in thousands):

Nine months ended September 30, 2017	Total	Level 1	Level 2	Level 3	Total Gains (Losses)
Fair value:					
Impaired Originated & PNCI loans	\$1,026	-	-	\$1,026	\$(892)
Foreclosed assets	2,062	-	-	2,062	(157)
Total assets measured at fair value	<u>\$3,088</u>	<u>-</u>	<u>-</u>	<u>\$3,088</u>	<u>\$(1,049)</u>

Year ended December 31, 2016	Total	Level 1	Level 2	Level 3	Total Gains (Losses)
Fair value:					
Impaired Originated & PNCI loans	\$1,107	-	-	\$1,107	\$(409)
Foreclosed assets	2,253	-	-	2,253	(86)
Total assets measured at fair value	<u>\$3,360</u>	<u>-</u>	<u>-</u>	<u>\$3,360</u>	<u>\$(495)</u>

Nine months ended September 30, 2016	Total	Level 1	Level 2	Level 3	Total Gains/(Losses)
Fair value:					
Impaired Originated & PNCI loans	\$5,941	-	-	\$5,941	\$(570)
Foreclosed assets	1,801	-	-	1,801	14
Total assets measured at fair value	<u>\$7,742</u>	<u>-</u>	<u>-</u>	<u>\$7,742</u>	<u>\$(556)</u>

The impaired Originated and PNCI loan amount above represents impaired, collateral dependent loans that have been adjusted to fair value. When we identify a collateral dependent loan as impaired, we measure the impairment using the current fair value of the collateral, less selling costs. Depending on the characteristics of a loan, the fair value of collateral is generally estimated by obtaining external appraisals. If we determine that the value of the impaired loan is less than the recorded investment in the loan, we recognize this impairment and adjust the carrying value of the loan to fair value through the allowance for loan and lease losses. The loss represents charge-offs or impairments on collateral dependent loans for fair value adjustments based on the fair value of collateral. The carrying value of loans fully charged-off is zero.

The foreclosed assets amount above represents impaired real estate that has been adjusted to fair value. Foreclosed assets represent real estate which the Bank has taken control of in partial or full satisfaction of loans. At the time of foreclosure, other real estate owned is recorded at fair value less costs to sell, which becomes the property's new basis. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan and lease losses. After foreclosure, management periodically performs valuations such that the real estate is carried at the lower of its new cost basis or fair value, net of estimated costs to sell. Fair value adjustments on other real estate owned are recognized within net loss on real estate owned. The loss represents impairments on non-covered other real estate owned for fair value adjustments based on the fair value of the real estate.

The Company's property appraisals are primarily based on the sales comparison approach and income approach methodologies, which consider recent sales of comparable properties, including their income generating characteristics, and then make adjustments to reflect the general assumptions that a market participant would make when analyzing the property for purchase. These adjustments may increase or decrease an appraised value and can vary significantly depending on the location, physical characteristics and income producing potential of each property. Additionally, the quality and volume of market information available at the time of the appraisal can vary from period to period and cause significant changes to the nature and magnitude of comparable sale adjustments. Given these variations, comparable sale adjustments are generally not a reliable indicator for how fair value will increase or decrease from period to period. Under certain circumstances, management discounts are applied based on specific characteristics of an individual property.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a nonrecurring basis at September 30, 2017:

	Fair Value (in thousands)	Valuation Technique	Unobservable Inputs	Range, Weighted Average
Impaired Originated & PNCI loans	\$1,026	Sales comparison approach	Adjustment for differences between comparable sales	(74)%-21%, (32%)
		Income approach	Capitalization rate	N/A
Foreclosed assets (Land & construction)	\$960	Sales comparison approach	Adjustment for differences between comparable sales	(53)%-283%, 230%
Foreclosed assets (residential (Residential real estate))	\$822	Sales comparison approach	Adjustment for differences between comparable sales	(47%)-39%, 3.3%
Foreclosed assets (Commercial real estate)	\$280	Sales comparison approach	Adjustment for differences between comparable sales	(46%)-63%, 26%

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a nonrecurring basis at December 31, 2016:

	Fair Value (in thousands)	Valuation Technique	Unobservable Inputs	Range, Weighted Average
Impaired Originated & PNCI loans	\$1,107	Sales comparison approach Income approach	Adjustment for differences between comparable sales Capitalization rate	Not meaningful N/A
Foreclosed assets (Land & construction)	\$15	Sales comparison approach	Adjustment for differences between comparable sales	Not meaningful
Foreclosed assets (residential) (Residential real estate)	\$1,564	Sales comparison approach	Adjustment for differences between comparable sales	Not meaningful
Foreclosed assets (Commercial real estate)	\$674	Sales comparison approach	Adjustment for differences between comparable sales	Not meaningful

In addition to the methods and assumptions used to estimate the fair value of each class of financial instrument noted above, the following methods and assumptions were used to estimate the fair value of other classes of financial instruments for which it is practical to estimate the fair value.

*Short-term Instruments* - Cash and due from banks, fed funds purchased and sold, interest receivable and payable, and short-term borrowings are considered short-term instruments. For these short-term instruments their carrying amount approximates their fair value.

*Securities held to maturity* - The fair value of securities held to maturity is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. The Company had no securities held to maturity classified as Level 3 during any of the periods covered in these financial statements.

*Restricted Equity Securities* - It is not practical to determine the fair value of restricted equity securities due to restrictions placed on their transferability.

*Originated and PNCI loans* - The fair value of variable rate originated and PNCI loans is the current carrying value. The interest rates on these originated and PNCI loans are regularly adjusted to market rates. The fair value of other types of fixed rate originated and PNCI loans is estimated by discounting the future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings for the same remaining maturities. The allowance for loan losses is a reasonable estimate of the valuation allowance needed to adjust computed fair values for credit quality of certain originated and PNCI loans in the portfolio.

*PCI Loans* - PCI loans are measured at estimated fair value on the date of acquisition. Carrying value is calculated as the present value of expected cash flows and approximates fair value.

*Deposit Liabilities* - The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date. These values do not consider the estimated fair value of the Company's core deposit intangible, which is a significant unrecognized asset of the Company. The fair value of time deposits and other borrowings is based on the discounted value of contractual cash flows.

*Other Borrowings* - The fair value of other borrowings is calculated based on the discounted value of the contractual cash flows using current rates at which such borrowings can currently be obtained.

*Junior Subordinated Debentures* - The fair value of junior subordinated debentures is estimated using a discounted cash flow model. The future cash flows of these instruments are extended to the next available redemption date or maturity date as appropriate based upon the spreads of recent issuances or quotes from brokers for comparable bank holding companies compared to the contractual spread of each junior subordinated debenture measured at fair value.

*Commitments to Extend Credit and Standby Letters of Credit* - The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit worthiness of the counter parties. For fixed rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligation with the counter parties at the reporting date.

Fair values for financial instruments are management's estimates of the values at which the instruments could be exchanged in a transaction between willing parties. These estimates are subjective and may vary significantly from amounts that would be realized in actual transactions. In addition, other significant assets are not considered financial assets including, any mortgage banking operations, deferred tax assets, and premises and equipment. Further, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on the fair value estimates and have not been considered in any of these estimates.

The estimated fair values of financial instruments that are reported at amortized cost in the Corporation's consolidated balance sheets, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value, were as follows (in thousands):

	September 30, 2017		December 31, 2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Level 1 inputs:				
Cash and due from banks	\$86,815	\$86,815	\$92,197	\$92,197
Cash at Federal Reserve and other banks	101,219	101,219	213,415	213,415
Level 2 inputs:				
Securities held to maturity	536,567	542,123	602,536	603,203
Restricted equity securities	16,956	N/A	16,956	N/A
Loans held for sale	2,733	2,733	2,998	2,998
Level 3 inputs:				
Loans, net	2,902,866	2,928,059	2,727,090	2,763,473
Financial liabilities:				
Level 2 inputs:				
Deposits	3,927,456	3,925,527	3,895,560	3,893,941
Other borrowings	98,730	98,730	17,493	17,493
Level 3 inputs:				
Junior subordinated debt	\$56,810	\$55,259	\$56,667	\$49,033
Off-balance sheet:				
Level 3 inputs:				
Commitments	\$909,900	\$9,099	\$767,274	\$7,673
Standby letters of credit	\$12,700	\$128	\$12,763	\$128
Overdraft privilege commitments	\$96,650	\$967	\$98,583	\$986

#### Note 28 - TriCo Bancshares Condensed Financial Statements (Parent Only)

##### Condensed Balance Sheets

	September 30, 2017	December 31, 2016
(In thousands)		
Assets		
Cash and Cash equivalents	\$3,278	\$2,802
Investment in Tri Counties Bank	558,986	529,907
Other assets	1,729	1,711
Total assets	<u>\$563,993</u>	<u>\$534,420</u>
Liabilities and shareholders' equity		
Other liabilities	\$450	\$406
Junior subordinated debt	56,810	56,667
Total liabilities	<u>57,260</u>	<u>57,073</u>
Shareholders' equity:		
Common stock, no par value: authorized 50,000,000 shares; issued and outstanding 22,941,464 and 22,867,802 shares, respectively	255,231	252,820
Retained earnings	256,114	232,440
Accumulated other comprehensive loss, net	(4,612)	(7,913)
Total shareholders' equity	<u>506,733</u>	<u>477,347</u>
Total liabilities and shareholders' equity	<u>\$563,993</u>	<u>\$534,420</u>

##### Statements of Income

(In thousands)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Interest expense	\$652	\$562	\$1,870	\$1,643
Administration expense	209	158	586	548
Loss before equity in net income of Tri Counties Bank	(861)	(720)	(2,456)	(2,191)
Equity in net income of Tri Counties Bank:				
Distributed	5,185	4,096	14,394	11,434
(Over) under distributed	7,211	8,522	24,594	22,116
Income tax benefit	362	301	1,033	919
Net income	<u>\$11,897</u>	<u>\$12,199</u>	<u>\$37,565</u>	<u>\$32,278</u>

**Note 28 - TriCo Bancshares Condensed Financial Statements (Parent Only, continued)**

<b>Statements of Comprehensive Income</b> (In thousands)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Net income	\$11,897	\$12,199	\$37,565	\$32,278
Other comprehensive income (loss), net of tax:				
Unrealized holding (losses) gains on available for sale securities arising during the period	(166)	(1,193)	3,137	6,514
Change in minimum pension liability	55	74	164	222
Change in joint beneficiary liability	-	(1)	-	(5)
Other comprehensive (loss) income	(111)	(1,120)	3,301	6,731
Comprehensive income	<u>\$11,786</u>	<u>\$11,079</u>	<u>\$40,866</u>	<u>\$39,009</u>
<b>Statements of Cash Flows</b> (In thousands)			<b>Nine months ended September 30,</b>	
			<b>2017</b>	<b>2016</b>
Operating activities:				
Net income			\$37,565	\$32,278
Adjustments to reconcile net income to net cash provided by operating activities:				
Over (under) distributed equity in earnings of Tri Counties Bank			(24,594)	(22,116)
Equity compensation vesting expense			1,184	1,078
Equity compensation net (excess tax benefit) tax expense			-	182
Net change in other assets and liabilities			(1,015)	(906)
Net cash provided by operating activities			<u>13,140</u>	<u>10,516</u>
Investing activities: None				
Financing activities:				
Issuance of common stock through option exercise			193	518
Equity compensation net (excess tax benefit) tax expense			-	(182)
Repurchase of common stock			(1,629)	(384)
Cash dividends paid — common			(11,228)	(10,265)
Net cash used for financing activities			<u>(12,664)</u>	<u>(10,313)</u>
Increase in cash and cash equivalents			<u>476</u>	<u>203</u>
Cash and cash equivalents at beginning of year			<u>2,802</u>	<u>2,565</u>
Cash and cash equivalents at end of year			<u>\$3,278</u>	<u>\$2,768</u>

**Note 29 - Regulatory Matters**

The Company is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the table below) of total, Tier 1, and common equity Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets.

The following tables present actual and required capital ratios as of September 30, 2017 and December 31, 2016 for the Company and the Bank under Basel III Capital Rules. The minimum capital amounts presented include the minimum required capital levels as of September 30, 2017 (1.25%) and December 31, 2016 (0.625%) based on the then phased-in provisions of the Basel III Capital Rules and the minimum required capital levels as of January 1, 2019 when the Basel III Capital Rules have been fully phased-in. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

	Actual		Minimum Capital Required – Basel III Phase-in Schedule		Minimum Capital Required – Basel III Fully Phased In		Required to be Considered Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2017:	(dollars in thousands)							
Total Capital								
(to Risk Weighted Assets):								
Consolidated	\$525,569	14.42%	\$337,117	9.250%	\$382,673	10.50%	N/A	N/A
Tri Counties Bank	\$522,718	14.35%	\$336,957	9.250%	\$382,492	10.50%	\$364,278	10.00%
Tier 1 Capital								
(to Risk Weighted Assets):								
Consolidated	\$493,833	13.55%	\$264,227	7.250%	\$309,783	8.50%	N/A	N/A
Tri Counties Bank	\$490,982	13.48%	\$264,102	7.250%	\$309,636	8.50%	\$291,422	8.00%
Common equity Tier 1 Capital								
(to Risk Weighted Assets):								
Consolidated	\$439,498	12.06%	\$209,559	5.750%	\$255,116	7.00%	N/A	N/A
Tri Counties Bank	\$490,982	13.48%	\$209,460	5.750%	\$254,995	7.00%	\$236,781	6.50%
Tier 1 Capital (to Average Assets):								
Consolidated	\$493,833	10.98%	\$179,925	4.000%	\$179,925	4.00%	N/A	N/A
Tri Counties Bank	\$490,982	10.92%	\$179,920	4.000%	\$179,920	4.00%	\$224,900	5.00%

	Actual		Minimum Capital Required – Basel III Phase-in Schedule		Minimum Capital Required – Basel III Fully Phased In		Required to be Considered Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2016:	(dollars in thousands)							
Total Capital								
(to Risk Weighted Assets):								
Consolidated	\$503,283	14.77%	\$293,854	8.625%	\$357,735	10.50%	N/A	N/A
Tri Counties Bank	\$500,876	14.71%	\$293,706	8.625%	\$357,556	10.50%	\$340,529	10.00%
Tier 1 Capital								
(to Risk Weighted Assets):								
Consolidated	\$468,061	13.74%	\$225,714	6.625%	\$289,595	8.50%	N/A	N/A
Tri Counties Bank	\$465,654	13.67%	\$225,601	6.625%	\$289,450	8.50%	\$274,725	8.00%
Common equity Tier 1 Capital								
(to Risk Weighted Assets):								
Consolidated	\$414,632	12.17%	\$174,609	5.125%	\$238,490	7.00%	N/A	N/A
Tri Counties Bank	\$465,654	13.66%	\$174,521	5.125%	\$238,370	7.00%	\$221,344	6.50%
Tier 1 Capital (to Average Assets):								
Consolidated	\$468,061	10.62%	\$176,346	4.000%	\$176,346	4.00%	N/A	N/A
Tri Counties Bank	\$465,654	10.56%	\$176,341	4.000%	\$176,341	4.00%	\$220,426	5.00%

As of September 30, 2017, capital levels at the Company and the Bank exceed all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis. Also, at September 30, 2017 and December 31, 2016, the Bank's capital levels exceeded the minimum amounts necessary to be considered well capitalized under the current regulatory framework for prompt corrective action.

Beginning January 1, 2016, the Basel III Capital Rules implemented a requirement for all banking organizations to maintain a capital conservation buffer above the minimum risk-based capital requirements in order to avoid certain limitations on capital distributions, stock repurchases and discretionary bonus payments to executive officers. The capital conservation buffer is exclusively composed of common equity tier 1 capital, and it applies to each of the risk-based capital ratios but not the leverage ratio. At September 30, 2017, the Company and the Bank are in compliance with the capital conservation buffer requirement. The three risk-based capital ratios will increase by 0.625% each year through 2019, at which point, the common equity tier 1 risk-based, tier 1 risk-based and total risk-based capital ratio minimums will be 7.0%, 8.5% and 10.5%, respectively.

### Note 30 - Summary of Quarterly Results of Operations (unaudited)

The following table sets forth the results of operations for the periods indicated, and is unaudited; however, in the opinion of Management, it reflects all adjustments (which include only normal recurring adjustments) necessary to present fairly the summarized results for such periods.

	2017 Quarters Ended		
	September 30,	June 30,	March 31,
	(dollars in thousands, except per share data)		
Interest and dividend income:			
Loans:			
Discount accretion PCI – cash basis	398	\$386	\$112
Discount accretion PCI – other	407	797	631
Discount accretion PNCI	559	987	798
All other loan interest income	<u>35,904</u>	<u>34,248</u>	<u>33,373</u>
Total loan interest income	37,268	36,418	34,914
Debt securities, dividends and interest bearing cash at Banks (not FTE)	<u>8,645</u>	<u>8,626</u>	<u>8,570</u>
Total interest income	45,913	45,044	43,484
Interest expense	<u>1,829</u>	<u>1,610</u>	<u>1,491</u>
Net interest income	44,084	43,434	41,993
Provision for (benefit from reversal of provision for) loan losses	<u>765</u>	<u>(796)</u>	<u>(1,557)</u>
Net interest income after provision for loan losses	43,319	44,230	43,550
Noninterest income	12,930	12,910	11,703
Noninterest expense	<u>37,222</u>	<u>35,904</u>	<u>35,822</u>
Income before income taxes	19,027	21,236	19,431
Income tax expense	<u>7,130</u>	<u>7,647</u>	<u>7,352</u>
Net income	<u>\$ 11,897</u>	<u>\$ 13,589</u>	<u>\$ 12,079</u>
Per common share:			
Net income (diluted)	<u>\$ 0.51</u>	<u>\$ 0.58</u>	<u>\$ 0.52</u>
Dividends	<u>\$ 0.17</u>	<u>\$ 0.17</u>	<u>\$ 0.15</u>

	2016 Quarters Ended			
	December 31,	September 30,	June 30,	March 31,
	(dollars in thousands, except per share data)			
Interest and dividend income:				
Loans:				
Discount accretion PCI – cash basis	\$483	\$777	\$426	\$269
Discount accretion PCI – other	658	569	415	(45)
Discount accretion PNCI	637	883	1,459	868
All other loan interest income	<u>34,463</u>	<u>33,540</u>	<u>32,038</u>	<u>33,646</u>
Total loan interest income	36,241	35,769	34,338	34,738
Debt securities, dividends and interest bearing cash at Banks (not FTE)	<u>8,374</u>	<u>7,940</u>	<u>8,252</u>	<u>8,056</u>
Total interest income	44,615	43,709	42,590	42,794
Interest expense	<u>1,460</u>	<u>1,439</u>	<u>1,430</u>	<u>1,392</u>
Net interest income	43,155	42,270	41,160	41,402
(Benefit from reversal of) provision for loan losses	<u>(1,433)</u>	<u>(3,973)</u>	<u>(773)</u>	<u>209</u>
Net interest income after provision for loan losses	44,588	46,243	41,933	41,193
Noninterest income	12,462	11,066	11,245	9,790
Noninterest expense	<u>36,563</u>	<u>37,416</u>	<u>38,267</u>	<u>33,751</u>
Income before income taxes	20,487	19,893	14,911	17,232
Income tax expense	<u>7,954</u>	<u>7,694</u>	<u>5,506</u>	<u>6,558</u>
Net income	<u>\$ 12,533</u>	<u>\$ 12,199</u>	<u>\$ 9,405</u>	<u>\$ 10,674</u>
Per common share:				
Net income (diluted)	<u>\$ 0.54</u>	<u>\$ 0.53</u>	<u>\$ 0.41</u>	<u>\$ 0.46</u>
Dividends	<u>\$ 0.15</u>	<u>\$ 0.15</u>	<u>\$ 0.15</u>	<u>\$ 0.15</u>



## **Note 31 – Subsequent Event**

On October 8, 2017, a series of wildfires broke out in several Northern California counties in which the Company conducts business. The hardest hit counties appear to be Sonoma and Napa counties with the City of Santa Rosa, and the surrounding Sonoma County area, being especially hard hit. It has been reported that several thousand homes and businesses have been destroyed as a result of these fires. As of October 24, 2017, the Company has identified 39 of its loans with total recorded balances of \$15,808,000 that are collateralized by properties within the evacuation zones established for these fires. Of these 39 loans, 32 loans with recorded balances of \$9,192,000 are collateralized by residential real estate, and seven loans with recorded balances of \$6,616,000 are collateralized by commercial real estate. Properties serving as collateral for nine of the 32 residential real estate loans, and representing \$2,636,000 of the recorded balance of loans, and properties serving as collateral for one of the seven commercial real estate loans, and representing \$4,062,000 of the recorded balance of loans, have been identified as being partially or totally destroyed. It is the policy of the Company to require borrowers to maintain property & casualty insurance on properties that serve as collateral for the Company's loans. Management is in the process of determining what the financial effects of these fires may have on the Company, but at this time, management does not believe any such effects will be material to the Company's financial condition, or results of operations.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **General**

As TriCo Bancshares (referred to in this report as "we", "our" or the "Company") has not commenced any business operations independent of Tri Counties Bank (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, 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, and the presentation of these measures 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 the Part I – Financial Information section of this Form 10-Q, 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**

There have been no changes to the Company's critical accounting policies during the nine months ended September 30, 2017.

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted 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 Item 1 of Part I of this report.

On March 18, 2016, Tri Counties Bank acquired three branches from Bank of America. The branches are located in the cities of Arcata, Eureka, and Fortuna in Humboldt County, California. The Bank paid \$3,204,000 for deposit relationships with balances totaling \$161,231,000 and loans with balances totaling \$289,000. See "Results of Operations" and "Financial Condition" below and Note 2 in Item 1 of Part I of this report, for additional discussion about this transaction.

On October 3, 2014, TriCo acquired North Valley Bancorp. As part of the acquisition, North Valley Bank, a wholly-owned subsidiary of North Valley Bancorp, merged with and into Tri Counties Bank. TriCo issued an aggregate of approximately 6.58 million shares of TriCo common stock to North Valley Bancorp shareholders, which was valued at a total of approximately \$151 million based on the closing trading price of TriCo common stock on October 3, 2014 of \$21.73 per share. TriCo also assumed North Valley Bancorp's obligations with respect to its outstanding trust preferred securities. North Valley Bank was a full-service commercial bank headquartered in Redding, California. North Valley Bank conducted a commercial and retail banking services which included accepting demand, savings, and money market rate deposit accounts and time deposits, and making commercial, real estate and consumer loans. North Valley Bank had \$935 million in assets and 22 commercial banking offices in Shasta, Humboldt, Del Norte, Mendocino, Yolo, Sonoma, Placer and Trinity Counties in Northern California at June 30, 2014. Between January 7, 2015 and January 21, 2015, four Tri Counties Bank branches and four former North Valley Bank branches were consolidated into other Tri Counties Bank or other former North Valley Bank branches.

On September 23, 2011, the California Department of Financial Institutions 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.

On May 28, 2010, the Office of the Comptroller of the Currency closed Granite Community Bank, N.A. ("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 covered 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 absorbed 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 had original terms of 5 years and 10 years, respectively, and the loss recovery provisions had original terms of 8 years and 10 years, respectively, from the acquisition date. On May 9, 2017, the Company and the FDIC agreed to terminate the whole bank purchase and assumption agreement with loss sharing. For further information regarding the whole bank purchase and assumption agreement with loss sharing, and its termination, see Note 11 in Item 1 of Part I of this report.

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 non-credit impaired” (PNCI) loans. The Company refers to loans that it originates as “originated” loans. Additional information regarding the Citizens and Granite Bank acquisitions can be found in Note 2 in Item 1 of Part I 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 Item 1 of Part I 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.

### TRICO BANCSHARES

#### Financial Summary

(In thousands, except per share amounts; unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Net Interest Income (FTE)	\$44,708	\$42,857	\$131,385	\$126,542
Provision for (benefit from reversal of provision for) loan losses	(765)	3,973	1,588	4,537
Noninterest income	12,930	11,066	37,543	32,101
Noninterest expense	(37,222)	(37,416)	(108,948)	(109,434)
Provision for income taxes (FTE)	(7,754)	(8,281)	(24,003)	(21,468)
Net income	\$11,897	\$12,199	\$37,565	\$32,278
Earnings per share:				
Basic	\$0.52	\$0.53	\$1.64	\$1.42
Diluted	\$0.51	\$0.53	\$1.62	\$1.40
Per share:				
Dividends paid	\$0.17	\$0.15	\$0.49	\$0.45
Book value at period end	\$22.09	\$21.11		
Average common shares outstanding	22,932	22,825	22,901	22,804
Average diluted common shares outstanding	23,244	23,099	23,239	23,077
Shares outstanding at period end	22,941	22,827		
At period end:				
Loans, net	\$2,902,866	\$2,678,742		
Total assets	4,656,435	4,467,131		
Total deposits	3,927,456	3,836,012		
Other borrowings	98,730	19,235		
Junior subordinated debt	56,810	56,617		
Shareholders’ equity	\$506,733	\$481,890		
Financial Ratios:				
During the period (annualized):				
Return on assets	1.04%	1.11%	1.11%	0.99%
Return on equity	9.38%	10.15%	10.09%	9.13%
Net interest margin <sup>1</sup>	4.24%	4.23%	4.21%	4.23%
Efficiency ratio <sup>2</sup>	64.6%	69.4%	64.5%	69.0%
Average equity to average assets	11.10%	10.90%	10.99%	10.87%
At period end:				
Equity to assets	10.88%	10.79%		
Total capital to risk-adjusted assets	14.42%	14.79%		

<sup>1</sup> Fully taxable equivalent (FTE)

<sup>2</sup> Efficiency ratio is defined as noninterest expense divided by the sum net interest income (FTE) and noninterest income.

## 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 Condensed Consolidated Financial Statements of the Company and the Notes thereto located at Item 1 of this report.

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Net Interest Income (FTE)	\$44,708	\$42,857	\$131,385	\$126,542
(Provision for) benefit from reversal of provision for loan losses	(765)	3,973	1,588	4,537
Noninterest income	12,930	11,066	37,543	32,101
Noninterest expense	(37,222)	(37,416)	(108,948)	(109,434)
Provision for income taxes (FTE)	(7,754)	(8,281)	(24,003)	(21,468)
Net income	<u>\$11,897</u>	<u>\$12,199</u>	<u>\$37,565</u>	<u>\$32,278</u>

Included in the Company's results of operations for the three and nine months ended September 30, 2017 is a gain of \$961,000 recorded in noninterest income from the sale of available for sale mortgage backed securities on September 28, 2017 with a book value of \$24,796,000 at the time of sale.

Also, included in the Company's results of operations for the nine months ended September 30, 2017 is noninterest income of \$712,000 related to the termination on May 9, 2017 of the loss sharing agreements between the Company and the FDIC that were originally agreed to in conjunction with the Company's acquisition of certain assets and liabilities of Granite Community Bank from the FDIC in May 2010. As part of the termination agreement, the Company paid the FDIC \$184,000, and recorded \$712,000 of noninterest income representing the difference between the Company's recorded loss share liability on May 9, 2017 and the payment to the FDIC.

Also, included in the Company's results of operations for the three and nine months ended September 30, 2017 are \$150,000 and \$847,000 of excess tax benefits (a reduction of tax expense) related to the exercise or release of equity compensation instruments during these time periods, respectively. Prior to January 1, 2017, generally accepted accounting principles required these types of excess tax benefits, and tax deficiencies, to be recorded directly to shareholders' equity, and not affect tax expense. During the three and nine month periods ended September 30, 2016, the Company recorded equity compensation related tax deficiencies of \$0 and \$182,000, respectively, to shareholders' equity.

Included in the Company's results of operations for the three and nine months ended September 30, 2016 is the impact of the sale on August 22, 2016, of two performing loans with recorded book value of \$166,000, and 48 nonperforming loans with recorded book value, including pre-sale write downs and purchase discounts, of approximately \$2,757,000. The loans sold on August 22, 2016 had contractual amounts outstanding of \$6,558,000. Net sale proceeds of \$4,980,000 resulted in the recovery of loan balances previously charged off of \$1,727,000, additional loan charge offs of \$159,000, and interest income of \$488,000 from the recovery of interest payments previously applied to principal balances.

Also, included in the Company's results of operations for the three and nine months ended September 30, 2016 was a \$716,000 valuation allowance expense related to a closed branch building held for sale, the value of which was written down to current market value, and subsequently sold during the three months ended September 30, 2016. Net proceeds from the sale of this building were \$1,218,000, and resulted in no gain or additional loss being recorded upon the sale of this building.

Included in the Company's results of operations for the nine month period ended September 30, 2016 is a \$1,450,000 litigation contingent liability expense accrual recorded during the three months ended June 30, 2016, and representing the Company's estimate of probable incurred losses associated with the legal proceedings originally brought against the Company on September 15, 2014 and January 20, 2015, and described further under the heading "*Legal Proceedings*" at Note 18 in Item 1 of Part I of this report.

Also, included in the Company's results of operations for the nine months ended September 30, 2016 is the impact of the sale, on March 31, 2016, of twenty-seven nonperforming loans, nine substandard performing loans, and three purchased credit impaired loans with total contractual principal balances outstanding of \$31,487,000, and recorded book value, including pre-sale write downs and purchase discounts, of approximately \$24,810,000. Net proceeds from the sale of these loans were \$27,049,000, and resulted in additional net loan write downs of \$21,000, the recovery of \$1,237,000 of interest income that was previously applied to the principal balance of loans in nonaccrual status, and a gain on sale of loans of \$103,000.

Also, included in the Company's results of operations for the nine months ended September 30, 2016 was \$784,000 of nonrecurring noninterest expense related to the Company's acquisition of three bank branches from Bank of America on March 18, 2016. The branches are located in the cities of Arcata, Eureka, and Fortuna in Humboldt County, California. The Bank paid \$3,204,000 for deposit relationships with balances of \$161,231,000 and loans with balances of \$289,000, and received \$159,520,000 in cash from Bank of America. The

acquisition of the deposits and cash in this acquisition, on March 18, 2016, had a muted effect on average assets and average deposit balances for the quarter ended March 31, 2016, but had full effect in the quarters thereafter.

### Net Interest Income

The Company's primary source of revenue is net interest income, or the difference between interest income on interest-earning assets and interest expense on interest-bearing liabilities. Following is a summary of the components of net interest income for the periods indicated (dollars in thousands):

	Three months ended September 30,		Nine month ended September 30,	
	2017	2016	2017	2016
Interest income	\$45,913	\$43,709	\$134,441	\$129,093
Interest expense	(1,829)	(1,439)	(4,930)	(4,261)
FTE adjustment	624	587	1,874	1,710
Net interest income (FTE)	<u>\$44,708</u>	<u>\$42,857</u>	<u>\$131,385</u>	<u>\$126,542</u>
Net interest margin (FTE)	<u>4.24%</u>	<u>4.23%</u>	<u>4.21%</u>	<u>4.23%</u>
Purchased loan discount accretion	\$1,364	\$2,229	\$5,075	\$5,621
Interest income recovered from sale of loans	-	\$488	-	\$1,725
Effect of purchased loan discount accretion on net interest margin (FTE)	0.13%	0.22%	0.16%	0.19%
Effect of interest income recovered from sale of loans on net interest margin (FTE)	-	0.05%	-	0.06%

### Summary of Average Balances, Yields/Rates and Interest Differential

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 interest-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 of 35% (dollars in thousands).

	For the three months ended					
	September 30, 2017			September 30, 2016		
	Average Balance	Interest Income/Expense	Rates Earned /Paid	Average Balance	Interest Income/Expense	Rates Earned /Paid
Assets:						
Loans	\$2,878,944	\$37,268	5.18%	\$2,669,954	\$35,769	5.36%
Investment securities - taxable	1,114,112	7,312	2.63%	1,073,030	6,687	2.49%
Investment securities - nontaxable	136,095	1,665	4.89%	126,910	1,565	4.93%
Cash at Federal Reserve and other banks	85,337	292	1.37%	185,552	275	0.59%
Total interest-earning assets	<u>4,214,488</u>	<u>46,537</u>	<u>4.42%</u>	<u>4,055,446</u>	<u>44,296</u>	<u>4.37%</u>
Other assets	<u>357,937</u>			<u>351,876</u>		
Total assets	<u>\$4,572,424</u>			<u>\$4,407,322</u>		
Liabilities and shareholders' equity:						
Interest-bearing demand deposits	\$949,348	206	0.09%	\$888,377	111	0.05%
Savings deposits	1,365,249	419	0.12%	1,357,359	426	0.13%
Time deposits	310,325	403	0.52%	340,709	338	0.40%
Other borrowings	65,234	149	0.91%	18,952	2	0.05%
Junior subordinated debt	56,784	652	4.59%	56,584	562	3.97%
Total interest-bearing liabilities	<u>2,746,941</u>	<u>1,829</u>	<u>0.27%</u>	<u>2,661,981</u>	<u>1,439</u>	<u>0.22%</u>
Noninterest-bearing deposits	1,253,261			1,198,302		
Other liabilities	64,834			66,464		
Shareholders' equity	<u>507,389</u>			<u>480,575</u>		
Total liabilities and shareholders' equity	<u>\$4,572,424</u>			<u>\$4,407,322</u>		
Net interest spread <sup>(1)</sup>			4.15%			4.15%
Net interest income and interest margin <sup>(2)</sup>		<u>\$44,708</u>	<u>4.24%</u>		<u>\$42,857</u>	<u>4.23%</u>

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

(2) Net interest margin is computed by calculating the difference between interest income and interest expense, divided by the average balance of interest-earning assets.

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

	For the nine months ended					
	September 30, 2017			September 30, 2016		
	Average Balance	Interest Income/Expense	Rates Earned /Paid	Average Balance	Interest Income/Expense	Rates Earned /Paid
<b>Assets:</b>						
Loans	\$2,807,453	\$108,600	5.16%	\$2,596,175	104,845	5.38%
Investment securities - taxable	1,076,887	21,637	2.68%	1,075,413	20,552	2.55%
Investment securities - nontaxable	136,213	4,998	4.89%	123,129	4,560	4.94%
Cash at Federal Reserve and other banks	139,739	1,080	1.03%	195,961	846	0.58%
Total interest-earning assets	4,160,292	136,315	4.37%	3,990,678	130,803	4.37%
Other assets	359,489			345,601		
Total assets	<u>\$4,519,781</u>			<u>\$4,336,279</u>		
<b>Liabilities and shareholders' equity:</b>						
Interest-bearing demand deposits	\$931,079	534	0.08%	\$873,742	347	0.05%
Savings deposits	1,364,812	1,253	0.12%	1,329,180	1,246	0.12%
Time deposits	321,150	1,109	0.46%	343,906	1,018	0.39%
Other borrowings	34,413	164	0.64%	18,790	7	0.05%
Junior subordinated debt	56,737	1,870	4.39%	56,541	1,643	3.87%
Total interest-bearing liabilities	2,708,191	4,930	0.24%	2,622,159	4,261	0.22%
Noninterest-bearing deposits	1,247,201			1,180,092		
Other liabilities	67,854			62,824		
Shareholders' equity	496,535			471,204		
Total liabilities and shareholders' equity	<u>\$4,519,781</u>			<u>\$4,336,279</u>		
Net interest spread <sup>(1)</sup>			4.13%			4.15%
Net interest income and interest margin <sup>(2)</sup>		<u>\$131,385</u>	<u>4.21%</u>		<u>126,542</u>	<u>4.23%</u>

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

(2) Net interest margin is computed by calculating the difference between interest income and interest expense, divided by the average balance of interest-earning assets.

**Summary of Changes in Interest Income and Expense due to Changes in Average Asset and Liability Balances and Yields Earned and Rates Paid**

The following table sets forth a summary of the changes in interest income and interest expense from changes in average asset and liability balances (volume) and changes in average interest rates for the periods indicated. Changes not solely attributable to volume or rates have been allocated in proportion to the respective volume and rate components (in thousands).

	Three months ended September 30, 2017 compared with three months ended September 30, 2016		
	Volume	Rate	Total
<b>Increase (decrease) in interest income:</b>			
Loans	\$2,800	\$(1,301)	\$1,499
Investment securities	369	356	725
Cash at Federal Reserve and other banks	(148)	165	17
Total interest-earning assets	<u>3,021</u>	<u>(780)</u>	<u>2,241</u>
<b>Increase (decrease) in interest expense:</b>			
Interest-bearing demand deposits	8	87	95
Savings deposits	3	(10)	(7)
Time deposits	(30)	95	65
Other borrowings	4	143	147
Junior subordinated debt	2	88	90
Total interest-bearing liabilities	<u>(13)</u>	<u>403</u>	<u>390</u>
Increase (decrease) in Net Interest Income	<u>\$3,034</u>	<u>\$(1,183)</u>	<u>\$1,851</u>

**Summary of Changes in Interest Income and Expense due to Changes in Average Asset and Liability Balances and Yields Earned and Rates Paid (continued)**

	Nine months ended September 30, 2017 compared with nine months ended September 30, 2016		
	Volume	Rate	Total
Increase (decrease) in interest income:			
Loans	\$8,525	\$(4,770)	\$3,755
Investment securities	513	1,010	1,523
Cash at Federal Reserve and other banks	(245)	479	234
Total interest-earning assets	8,793	(3,281)	5,512
Increase (decrease) in interest expense:			
Interest-bearing demand deposits	22	165	187
Savings deposits	32	(25)	7
Time deposits	(67)	158	91
Other borrowings	6	151	157
Junior subordinated debt	6	221	227
Total interest-bearing liabilities	(1)	670	669
Increase (decrease) in Net Interest Income	\$6,794	\$(3,951)	\$4,843

The following commentary regarding net interest income, interest income and interest expense may be best understood while referencing the *Summary of Average Balances, Yields/Rates and Interest Differential* and the *Summary of Changes in Interest Income and Expense due to Changes in Average Asset and Liability Balances and Yields Earned and Rates Paid* shown above, and Note 30 to the Consolidated Financial Statements at Part I, Item 1 of this report.

Net interest income (FTE) during the three months ended September 30, 2017 increased \$1,851,000 (4.3%) from the same period in 2016 to \$44,708,000. The increase in net interest income (FTE) was due primarily to increases in the average balance of loans and investments, and an increase in yield on investments – taxable, that were partially offset by a decrease in yield on loans and an increase in other borrowings compared to the three months ended September 30, 2016.

Net interest income (FTE) during the nine months ended September 30, 2017 increased \$4,843,000 (3.8%) from the same period in 2016 to \$131,385,000. The increase in net interest income (FTE) was due primarily to increases in the average balance of loans and investments, and an increase in yield on investments – taxable, that were partially offset by a decrease in the average yield on loans and an increase in other borrowings compared to the nine months ended September 30, 2016.

During the three months ended September 30, 2017, loan interest income increased \$1,499,000 (4.2%) to \$37,268,000. The increase in loan interest income was due to a \$208,990,000 (7.8%) increase in the average balance of loans that was partially offset by an 18 basis point decrease in the average yield on loans to 5.18% compared to 5.36% during the three months ended September 30, 2016. Included in loan interest income for the quarter ended September 30, 2017 was \$1,364,000 of purchased loan discount accretion. Included in loan interest income for the quarter ended September 30, 2016 was \$2,229,000 of purchased loan discount accretion, and \$488,000 of interest income recovered upon the sale of certain nonperforming loans. During the three months ended September 30, 2017, investment interest income (FTE) increased \$725,000 (8.8%) from the year-ago quarter to \$8,977,000. The increase in investment interest income was due to a \$50,267,000 (4.2%) increase in the average balance of investments and a 12 basis point increase in the average investment yield to 2.87% compared to 2.75% in the year-ago quarter. The increase in loan and investment balances noted above was funded primarily by a \$93,436,000 (2.5%) increase in the average balance of total deposits, a \$100,215,000 (54.0%) decrease in the average balance of interest earning cash at banks, and a \$46,282,000 (244%) increase in other borrowings during the three months ended September 30, 2017 compared to the three months ended September 30, 2016. Despite the 54.0% decrease in the average balance of interest earning cash at banks, interest income from cash at banks increased \$17,000 (6.2%) to \$292,000 due to a 78 basis point increase in the average yield on cash at banks to 1.37% during the three months ended September 30, 2017 compared to 0.59% during the three months ended September 30, 2016. While the average balance of total deposits grew \$93,436,000 (2.5%) from the three months ended September 30, 2016 to the three months ended September 30, 2017, the average balance of interest bearing deposits grew \$38,477,000 (1.5%), and the average rate paid on those interest bearing deposits increased 2 basis points to 0.16%. The \$46,282,000 increase in the average balance of other borrowings was due to the addition of borrowings from the FHLB, and resulted in an 86 basis point increase in the average rate paid on other borrowings during the three months ended September 30, 2017 compared to the three months ended September 30, 2016. The average rate paid on junior subordinated debt increased 62 basis points to 4.59% during the three months ended September 30, 2017 compared to 3.97% during the three months ended September 30, 2016. The changes in the average balances of interest bearing assets and liabilities, and their respective yields and rates, from the three months ended September 30, 2016 to the three months ended September 30, 2017 is indicative of moderate to strong loan demand and loan origination capabilities of the Company from September 30, 2016 to September 30, 2017, and the increases in short-term interest rates during this time frame that did not result in significant increases in deposit rates or long-term fixed-rate loan rates.

The Federal Reserve has increased the Federal Funds target rate 25 basis points in each of December 2015, December 2016, March 2017, and June 2017; and the widely used prime rate of lending index has mirrored these increases in the Federal Funds rate, increasing from 3.25% in December 2015 to 4.25% in June 2017. While a significant portion of the Bank's loans are indexed to the prime lending rate, and have rates that reset on or near the date of any prime lending rate change, the positive effect of such prime lending rate changes have been substantially offset by loan renewals and originations at market rates that are lower than the average rate of the Bank's loan portfolio.

As of September 30, 2017, the Bank's \$2,955,323,000 principal balance of loans, net of charge-offs, and not including deferred loan fees and purchase discounts, was made up of loans with principal balances totaling \$1,051,513,000 that have fixed interest rates, and \$1,903,810,000

of loans with interest rates that are variable. Included in the balance of variable rate loans as of September 30, 2017 were loans with principal balances of approximately \$526,070,000 that had adjustable interest rates tied to the prime lending rate that adjust on or near the date of any prime rate change, and of which approximately \$59,100,000 had minimum contractual interest rates that are higher than their prime-indexed rate and will not experience an interest rate increase until their prime-indexed rate exceeds their minimum contractual interest rate. Also included in the balance of variable rate loans as of September 30, 2017 were loans with principal balances of approximately \$945,801,000 that had adjustable interest rates tied to the 5-year U.S. Treasury Bond Rate index (5-year CMT index), and of which approximately \$300,117,000 had minimum contractual interest rates that are higher than their 5-year CMT-indexed rate and will not experience an interest rate increase until their 5-year CMT-indexed rate exceeds their minimum contractual interest rate on their reset date. These 5-year CMT indexed loans have interest rates that adjust once every five years. Of course, any of these prime-indexed, 5-year CMT-indexed, or any other variable rate loan, may payoff, or may be refinanced, at any time.

During the nine months ended September 30, 2017, interest income (FTE) increased \$4,843,000 (3.9%) to \$131,385,000 compared to \$126,542,000 during the nine months ended September 30, 2016. This increase in interest income was due primarily to a \$3,755,000 (3.6%) increase in loan interest income to \$108,600,000. This increase in loan interest income was due to a \$211,278,000 (8.1%) increase in the average balance of loans that was partially offset by a 22 basis point decrease in the average loan yield to 5.16% compared to 5.38% during the nine months ended September 30, 2016. Included in loan interest income for the nine months ended September 30, 2017 was \$5,075,000 of purchased loan discount accretion. Included in loan interest income for the nine months ended September 30, 2016 was \$5,621,000 of purchased loan discount accretion, and \$1,725,000 of interest income recovered as the result of the loan sales during the nine months ended September 30, 2016. During the nine months ended September 30, 2017, investment interest income (FTE) increased \$1,523,000 (6.1%) to \$26,635,000 compared to the nine months ended September 30, 2016. This increase in investment interest income was due primarily to a 13 basis point increase in the average yield on investments to 2.93% compared to 2.79%. The increase in loan balances noted above was funded primarily by a \$137,322,000 (3.7%) increase in the average balance of total deposits, a \$56,222,000 (28.7%) decrease in the average balance of interest earning cash at banks, and a \$15,623,000 (83.1%) increase in other borrowings during the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016. Despite the 28.7% decrease in the average balance of interest earning cash at banks, interest income from cash at banks increased \$234,000 (27.7%) to \$1,080,000 due to a 45 basis point increase in the average yield on cash at banks during the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016. While the average balance of total deposits grew \$137,322,000 (3.7%) from the nine months ended September 30, 2016 to the nine months ended September 30, 2017, the average balance of interest earning deposits grew \$70,213,000 (2.7%), and the average rate paid on those interest earning deposits increased 1 basis point to 0.22%. The \$15,623,000 increase in the average balance of other borrowings was due to the addition of borrowings from the FHLB, and resulted in a 59 basis point increase in the average rate paid on other borrowings during the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016. The average rate paid on junior subordinated debt increased 52 basis points to 4.39% during the nine months ended September 30, 2017 compared to 3.87% during the nine months ended September 30, 2016. The changes in the average balances of interest bearing assets and liabilities, and their respective yields and rates, from the nine months ended September 30, 2016 to the nine months ended September 30, 2017 is indicative of moderate to strong loan demand from September 30, 2016 to September 30, 2017, and the increases in short-term interest rates during this time frame that did not result in significant increases in deposit rates or long-term fixed-rate loan rates.

#### **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 – three and nine months ended September 30, 2017 and 2016*” at Note 5 in Item 1 of Part I of this report for the components that make up the provision for loan losses for the three and nine months ended September 30, 2017 and 2016.

Increases and decreases in estimated cash flows and collateral values, changes in historical loss factors, changes in concentration levels, and changes in economic environmental factors, in part, determine the required loan loss allowance, and provision for loan losses, for nonperforming and 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 1 of Part I of this report. For details of the change in nonperforming loans during the three months ended September 30, 2017 see the Tables, and associated narratives, labeled “*Changes in nonperforming assets during the three months ended September 30, 2017*” under the heading “*Asset Quality and Non-Performing Assets*” below. For details of the change in nonperforming loans during the nine months ended September 30, 2017 see the Tables, and associated narratives, labeled “*Changes in nonperforming assets during the nine months ended September 30, 2017*” under the heading “*Asset Quality and Non-Performing Assets*” below.

The Company recorded a provision for loan losses of \$765,000 during the three months ended September 30, 2017 compared to a reversal of provision for loan losses of \$3,973,000 during the three months ended September 30, 2016. The \$765,000 provision for loan losses during the three months ended September 30, 2017 was primarily due to a \$4,525,000 increase in nonperforming loans, and an increase in the concentration of nonowner-occupied commercial real estate secured loans that were partially offset by continued low historical loan loss experience, and stable to improving economic environmental factors. Nonperforming loans were \$21,954,000, or 0.75% of loans outstanding as of September 30, 2017, and represented an increase from 0.73% of loans outstanding at December 31, 2016, and a decrease from 0.77% of loans outstanding as of September 30, 2016. Net loan charge-offs during the three months ended September 30, 2017 were \$161,000, and included \$187,000 of charge-offs related to purchased credit impaired (PCI-other) loans for which an allowance was previously provided. Excluding these PCI loan charge-offs, charge-offs for the three months ended September 30, 2017 would have been \$675,000, and charge-offs, net of recoveries, would have been a net recovery of \$26,000.

As shown in the Table labeled “*Allowance for Loan Losses – Three Months Ended September 30, 2017*” at Note 5 in Item 1 of Part I of this report, home equity lines of credit and home equity loans experienced a benefit from reversal of provision for loan losses while, residential and commercial real estate mortgage loans, other consumer loans, C&I loans, residential construction loans, and commercial construction

loans experienced a provision for loan losses during the three months ended September 30, 2017. The level of provision, or reversal of provision, for loan losses of each loan category during the three months ended September 30, 2017 was due primarily to the increase or decrease in the required allowance for loan losses as of September 30, 2017 when compared to the required allowance for loan losses as of June 30, 2017 plus or minus net charge-offs or net recoveries during the three months ended September 30, 2017. All categories of loans except home equity lines, home equity loans, and other consumer loans experienced an increase in the required allowance for loan losses during the three months ended September 30, 2017. The decreases in the required allowance for loan losses for home equity lines, home equity loans, and other consumer loans were due primarily to stable or improving estimated cash flows and collateral values for certain impaired originated and purchased loans, continued low net charge off rates in many loan categories, and stable to improving economic environmental factors. The increase in the required allowance for loan losses for commercial real estate mortgage loans was due primarily to the increases in the outstanding balances and the level of nonperforming balances of these types of loans. The increase in the required allowance for loan losses for residential real estate mortgage, and commercial & industrial loans were due primarily to the increases in the outstanding balances and the level of nonperforming balances of these types of loans. The increase in the required allowance for loan losses for residential and commercial construction loans were due primarily to the increases in the outstanding balances of these types of loans.

The Company recorded a reversal of provision for loan losses of \$1,588,000 during the nine months ended September 30, 2017 compared to a reversal of provision for loan losses of \$4,537,000 during the nine months ended September 30, 2016. The \$1,588,000 reversal of provision for loan losses during the nine months ended September 30, 2017 was primarily due to a continued low historical loan loss experience, and stable to improving economic environmental factors that were partially offset by a \$1,826,000 increase in nonperforming loans, and an increase in the concentration of nonowner-occupied commercial real estate secured loans. Net loan charge-offs during the nine months ended September 30, 2017 were \$2,168,000, and included \$1,832,000 of charge-offs related to purchased credit impaired (PCI-other) loans for which an allowance was previously established. Excluding these PCI loan charge-offs, charge-offs for the nine months ended September 30, 2017 would have been \$1,951,000, and charge-offs, net of recoveries, would have been \$336,000.

As shown in the Table labeled “*Allowance for Loan Losses – Nine Months Ended September 30, 2017*” at Note 5 in Item 1 of Part I of this report, residential and commercial real estate mortgage loans, home equity lines of credit, home equity loans, C&I loans and commercial construction loans experienced a benefit from reversal of provision for loan losses while, other consumer loans, and residential construction loans experienced a provision for loan losses during the nine months ended September 30, 2017. The level of provision, or reversal of provision, for loan losses of each loan category during the nine months ended September 30, 2017 was due primarily to the increase or decrease in the required allowance for loan losses as of September 30, 2017 when compared to the required allowance for loan losses as of December 31, 2016 plus or minus net charge-offs or net recoveries during the nine months ended September 30, 2017. All categories of loans except other residential construction loans experienced a decrease in the required allowance for loan losses during the nine months ended September 30, 2017. The increase in the required allowance for loan losses for residential construction loans was due primarily to increased balances in this loan category. The decrease in the required allowance for loan losses for all loan categories except residential construction was due primarily to stable or improving estimated cash flows and collateral values for certain impaired originated and purchased loans, continued low net charge off rates in many loan categories, and stable to improving economic environmental factors.

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 (in thousands):

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Service charges on deposit accounts	\$4,160	\$3,641	\$12,102	\$10,549
ATM and interchange fees	4,209	3,851	12,472	11,136
Other service fees	917	792	2,521	2,369
Mortgage banking service fees	514	537	1,561	1,570
Change in value of mortgage servicing rights	(325)	(799)	(795)	(2,198)
Total service charges and fees	9,475	8,022	27,861	23,426
Gain on sale of loans	606	953	2,293	2,645
Commissions on sale of non-deposit investment products	672	747	1,984	1,890
Increase in cash value of life insurance	732	709	2,043	2,086
Gain on sale of investment securities	961	-	961	-
Change in indemnification asset	-	(10)	490	(274)
Gain on sale of foreclosed assets	37	69	308	218
Sale of customer checks	89	110	287	299
Lease brokerage income	234	172	601	602
Loss on disposal of fixed assets	(33)	(13)	(61)	(52)
Life Insurance death benefit in excess of cash value	-	-	108	238
Other	157	307	668	1,023
Total other noninterest income	3,455	3,044	9,682	8,675
Total noninterest income	\$12,930	\$11,066	\$37,543	\$32,101
Mortgage loan servicing fees, net of change in fair value of mortgage loan servicing rights	\$189	\$(262)	\$766	\$(628)

Noninterest income increased \$1,864,000 (16.8%) to \$12,930,000 during the three months ended September 30, 2017 compared to the three months ended September 30, 2016. The increase in noninterest income was due primarily to a \$519,000 (14.3%) increase in service charges on deposit accounts, a \$358,000 (9.3%) increase in ATM fees and interchange income, a \$474,000 improvement in change in value of mortgage servicing rights, and a \$961,000 gain on sale of investment securities that were partially offset by a \$347,000 decrease in gain on sale of loans. The \$519,000 increase in service charges on deposit accounts was due primarily to increased fee generation from both consumer and business checking customers. The \$358,000 increase in ATM fees and interchange revenue was due primarily to the Company's continued focus in this area, and growth in electronic payments volume. The \$474,000 improvement in change in value of mortgage servicing rights (MSRs) was due primarily to an increase in the discount rate used by investors to calculate the present value of future servicing fee income that caused the fair value of the servicing asset to decrease during the three months ended September 30, 2016 while no similar discount rate increase occurred during the three months ended September 30, 2017. The \$961,000 gain on sale of investment securities was due to the Company's decision to sell \$24,796,000 of investment securities during the three months ended September 30, 2017. The \$347,000 decrease in gain on sale of loans was due primarily to decreased residential mortgage refinance activity compared to the year-ago quarter.

Noninterest income increased \$5,442,000 (17.0%) to \$37,543,000 during the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016. The increase in noninterest income was due primarily to a \$1,553,000 (14.7%) increase in service charges on deposit accounts, a \$1,336,000 (12.0%) increase in ATM fees and interchange income, a \$1,403,000 improvement in change in value of mortgage servicing rights, a \$961,000 gain on sale of investment securities, and a \$764,000 improvement in change in indemnification asset that were partially offset by a \$355,000 decrease in other noninterest income, and a \$352,000 decrease in gain on sale of loans. The \$1,553,000 increase in service charges on deposit accounts was due primarily to increased fee generation from both consumer and business checking customers. The \$1,336,000 increase in ATM fees and interchange revenue was due primarily to the Company's continued focus in this area, new services, fees, and operational changes introduced throughout 2016, and growth in electronic payments volume. The \$1,403,000 improvement in change in value of mortgage servicing rights (MSRs) was due to a smaller increase in the estimated weighted-average prepayment speed of the loans being service during the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016, and an increase in the discount rate used by investors to calculate the present value of future servicing fee income during the nine months ended September 30, 2016 while no such increase occurred during the nine months ended September 30, 2017. The \$961,000 gain on sale of investment securities was due to the Company's decision to sell \$24,796,000 of investment securities during the three months ended September 30, 2017. The \$764,000 improvement in change in indemnification asset was due to the early termination of the related loss sharing agreements between the Company and the FDIC. As part of the termination agreement, the Company paid the FDIC \$184,000, and recorded a \$712,000 gain representing the difference between the Company's payment to the FDIC and the recorded payable balance on May 9, 2017. The \$352,000 decrease in gain on sale of loans was due primarily to decreased residential mortgage refinance activity compared to the year-ago period.

**Noninterest Expense**

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Base salaries, net of deferred loan origination costs	\$13,600	\$13,419	\$40,647	\$39,095
Incentive compensation	2,609	2,798	6,980	7,008
Benefits and other compensation costs	4,724	4,643	14,693	14,067
Total salaries and benefits expense	<u>20,933</u>	<u>20,860</u>	<u>62,320</u>	<u>60,170</u>
Occupancy	2,799	2,667	8,196	7,504
Equipment	1,816	1,607	5,344	4,837
Data processing and software	2,495	2,068	7,332	6,266
ATM & POS network charges	1,425	1,915	3,353	3,923
Telecommunications	716	702	2,027	2,085
Postage	325	381	1,058	1,186
Courier service	235	280	752	816
Advertising	1,039	1,049	3,173	3,021
Assessments	427	654	1,252	1,864
Operational losses	301	497	1,166	1,006
Professional fees	901	1,018	2,357	3,183
Foreclosed assets expense	41	37	117	197
Provision for foreclosed asset losses	134	8	162	40
Change in reserve for unfunded commitments	390	25	270	433
Intangible amortization	339	359	1,050	1,017
Merger expense	-	-	-	784
Litigation contingent liability	-	-	-	1,450
Other	2,906	3,289	9,019	9,652
Total other noninterest expense	<u>16,289</u>	<u>16,556</u>	<u>46,628</u>	<u>49,264</u>
Total noninterest expense	<u>\$37,222</u>	<u>\$37,416</u>	<u>\$108,948</u>	<u>\$109,434</u>
Merger expense:				
Base salaries (outside temporary help)	-	-	-	\$187
Equipment	-	-	-	35
Data processing and software	-	-	-	-
Professional fees	-	-	-	342
Advertising and marketing	-	-	-	114
Other	-	-	-	106
Total merger expense	<u>-</u>	<u>-</u>	<u>-</u>	<u>\$784</u>
Average full time equivalent staff	993	1,022	1,005	996
Noninterest expense to revenue (FTE)	64.6%	69.4%	64.5%	69.0%

Salary and benefit expenses increased \$73,000 (0.3%) to \$20,933,000 during the three months ended September 30, 2017 compared to \$20,860,000 during the three months ended September 30, 2016. Base salaries, net of deferred loan origination costs increased \$181,000 (1.3%) to 13,600,000. The increase in base salaries was due primarily to annual merit increases that were substantially offset by a 2.8% decrease in average full time equivalent employees to 993 from 1,022 in the year-ago quarter. Commissions and incentive compensation decreased \$189,000 (6.8%) to \$2,609,000 during the three months ended September 30, 2017 compared to the year-ago quarter due primarily to a decrease in commissions on loans. Benefits & other compensation expense increased \$81,000 (1.7%) to \$4,724,000 during the three months ended September 30, 2017 due primarily to increases in group medical and workers compensation insurance, and employee stock ownership plan (ESOP) expense.

Salary and benefit expenses increased \$2,150,000 (3.6%) to \$62,320,000 during the nine months ended September 30, 2017 compared to \$60,170,000 during the nine months ended September 30, 2016. Base salaries, net of deferred loan origination costs increased \$1,552,000 (4.0%) to \$40,647,000. The increase in base salaries was due primarily to annual merit increases and a 0.9% increase in average full time equivalent employees to 1,005 from 996 during the nine months ended September 30, 2016. Commissions and incentive compensation decreased \$28,000 (0.4%) to \$6,980,000 due primarily to a decreases in commissions on loans. Benefits & other compensation expense increased \$626,000 (4.5%) to \$14,693,000 during the nine months ended September 30, 2017 due primarily to increases in group medical and workers compensation insurance, and employee stock ownership plan (ESOP) expense.

Other noninterest expense decreased \$267,000 (1.6%) to \$16,289,000 during the three months ended September 30, 2017 compared to the three months ended September 30, 2016. The decrease in other noninterest expense was due primarily to a \$490,000 decrease in ATM & POS network charges, a \$227,000 decrease in deposit insurance and other assessments, and a \$383,000 decrease in other noninterest expense that were partially offset by increases of \$427,000 in data processing and software expense, \$365,000 in change in reserve for unfunded commitments, and \$341,000 in occupancy and equipment expense. The \$490,000 decrease in ATM & POS network charges was due to nonrecurring ATM & POS network charges that occurred during the third quarter of 2016 related to system enhancements. The \$227,000 decrease in assessments was due the lowering of FDIC deposit insurance rates during the third quarter of 2016. The \$383,000 decrease in other noninterest expense was due to a \$716,000 valuation allowance expense taken during the third quarter of 2016 on a closed branch

building that was also sold during the third quarter of 2016 without further loss or gain. The \$365,000 increase in change in reserve for unfunded commitments was due primarily to a larger increase in unfunded loan commitments during the three months ended September 30, 2017, compared to the three months ended September 30, 2016. The \$341,000 increase in occupancy and equipment expense was due primarily to increased depreciation expense on equipment and maintenance and repair expense on facilities and equipment.

Other noninterest expense decreased \$2,636,000 (5.4%) to \$46,628,000 during the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016. The decrease in other noninterest expense was due primarily to the absence of any litigation settlement expense, merger expenses, or fixed asset valuation expenses during the nine months ended September 30, 2017 compared to a litigation settlement expense of \$1,450,000, merger expenses of \$784,000, and \$716,000 fixed asset valuation expense during the nine months ended September 30, 2016. Also contributing to the decrease in other noninterest expense during the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016 were a \$826,000 decrease in professional fees, a \$612,000 decrease in assessments, and a \$570,000 decrease in ATM & POS network charges that were partially offset by a \$1,199,000 increase in occupancy and equipment expenses, and a \$1,066,000 increase in data processing and software expense. The \$826,000 decrease in professional fees was due to system conversion related consulting fees incurred during the nine months ended September 30, 2016. The \$612,000 decrease in assessments was due the lowering of FDIC deposit insurance rates during the third quarter of 2016. The \$570,000 decrease in ATM & POS network charges was due to nonrecurring ATM & POS network charges that occurred during the third quarter of 2016 related to system enhancements. The \$1,199,000 increase in occupancy and equipment expenses was due primarily to increased building and equipment maintenance expense. The increased data processing and software expense is due primarily to the outsourcing of the Company's core processing system, and other ancillary systems in 2016.

### Income Taxes

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Federal statutory income tax rate	35.0%	35.0%	35.0%	35.0%
State income taxes, net of federal tax benefit	6.9	6.9	6.8	6.7
Tax-exempt interest on municipal obligations	(1.9)	(1.7)	(1.8)	(1.9)
Increase in cash value of insurance policies	(1.3)	(1.2)	(1.3)	(1.6)
Low income housing tax credits	(0.5)	(0.3)	(0.4)	(0.3)
Equity compensation	(0.8)	-	(1.4)	-
Other	0.1	-	0.2	0.1
Effective Tax Rate	<u>37.5%</u>	<u>38.7%</u>	<u>37.1%</u>	<u>38.0%</u>

The effective combined Federal and State income tax rate on income was 37.5% and 38.7% for the three months ended September 30, 2017 and 2016, respectively. The effective combined Federal and State income tax rate was greater than the Federal statutory tax rate of 35.0% due to State income tax expense of \$2,010,000 and \$2,123,000, respectively, in these periods that were partially offset by the effects of tax-exempt income of \$1,041,000 and \$978,000, respectively, from investment securities, \$732,000 and \$709,000, respectively, from increase in cash value of life insurance, low-income housing tax credits of \$94,000 and \$62,000, respectively, and \$150,000 and \$0, respectively, of equity compensation excess tax benefits. The low income housing tax credits and the equity compensation excess tax benefits represent direct reductions in tax expense. These offsetting items helped to reduce the effective combined Federal and State income tax rate from the combined Federal and State statutory income tax rate of approximately 42.0%.

The effective combined Federal and State income tax rate on income was 37.1% and 38.0% for the nine months ended September 30, 2017 and 2016, respectively. The effective combined Federal and State income tax rate was greater than the Federal statutory tax rate of 35.0% due to State income tax expense of \$6,205,000 and \$5,381,000, respectively, in these periods that were partially offset by the effects of tax-exempt income of \$3,124,000 and \$2,850,000, respectively, from investment securities, \$2,151,000 and \$2,324,000, respectively, from increase in cash value of life insurance, low-income housing tax credits of \$265,000 and \$135,000, respectively, and \$847,000 and \$0, respectively, of equity compensation related excess tax benefits. These offsetting items helped to reduce the effective combined Federal and State income tax rate from the combined Federal and State statutory income tax rate of approximately 42.0%.

On January 1, 2017, ASU No. 2016-9, *Compensation – Stock Compensation (Topic 718)* became effective for the Company. ASU 2016-9, among other things, requires that all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) should be recognized as income tax expense or benefit in the income statement. As noted above, the Company recognized \$150,000 and \$847,000 of excess tax benefits (in the income statement) during the three and nine month periods ended September 30, 2017, respectively. Prior to January 1, 2017, such excess tax benefits and deficiencies were recorded directly to shareholders' equity (and not in the income statement). During the three and nine month periods ended September 30, 2016, the Company recorded equity compensation related tax deficiencies of \$0 and \$182,000, respectively, to shareholders' equity.

## **Financial Condition**

### **Investment Securities**

Investment securities available for sale increased \$128,003,000 to \$678,236,000 as of September 30, 2017, compared to December 31, 2016. This increase is attributable to purchases of \$195,465,000, maturities and principal repayments of \$46,646,000, sales of securities with book value of \$24,796,000 for proceeds due from broker of \$25,757,000, an increase in fair value of investments securities available for sale of \$5,411,000 and amortization of net purchase price premiums of \$1,430,000.

The following table presents the available for sale investment securities portfolio by major type as of September 30, 2017 and December 31, 2016:

(In thousands)	September 30, 2017		December 31, 2016	
	Fair Value	%	Fair Value	%
Securities available for sale:				
Obligations of U.S. government corporations and agencies	\$554,062	81.7%	\$429,678	78.1%
Obligations of states and political subdivisions	121,217	17.9%	117,617	21.4%
Marketable equity securities	2,957	0.4%	2,938	0.5%
Total securities available for sale	<u>\$678,236</u>	<u>100.0%</u>	<u>\$550,233</u>	<u>100.0%</u>

Investment securities held to maturity decreased \$65,969,000 to \$536,567,000 as of September 30, 2017, as compared to December 31, 2016. This decrease is attributable to principal repayments of \$64,969,000, and amortization of net purchase price premiums of \$1,000,000.

The following table presents the held to maturity investment securities portfolio by major type as of September 30, 2017 and December 31, 2016:

(In thousands)	September 30, 2017		December 31, 2016	
	Cost Basis	%	Cost Basis	%
Securities held to maturity:				
Obligations of U.S. government corporations and agencies	\$521,999	97.3%	\$587,982	97.6%
Obligations of states and political subdivisions	14,568	2.7%	14,554	2.4%
Total securities held to maturity	<u>\$536,567</u>	<u>100.0%</u>	<u>\$602,536</u>	<u>100.0%</u>

Additional information about the investment portfolio is provided in Note 3 of the Notes to Unaudited Condensed Consolidated Financial Statements at Item 1 of Part I of this report.

### **Restricted Equity Securities**

Restricted equity securities were \$16,956,000 at September 30, 2017 and December 31, 2016. The entire balance of restricted equity securities at September 30, 2017 and December 31, 2016 represent the Bank's investment in the Federal Home Loan Bank of San Francisco ("FHLB").

Additional information about the restricted equity securities is provided in Note 1 of the Notes to Unaudited Condensed Consolidated Financial Statements at Item 1 of Part I of this report.

### **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.

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

(In thousands)	September 30,	December 31,
	2017	2016
Real estate mortgage	\$2,194,874	\$2,053,464
Consumer	361,320	366,663
Commercial	227,479	217,047
Real estate construction	147,940	122,419
Total loans	<u>\$2,931,613</u>	<u>\$2,759,593</u>

At September 30, 2017 loans, including net deferred loan costs, totaled \$2,931,613,000 which was a \$172,020,000 (6.2%) increase over the balances at December 31, 2016. Demand for all categories of loans was moderate to strong during the nine months ended September 30, 2017.

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

	September 30, 2017	December 31, 2016
Real estate mortgage	74.9%	74.4%
Consumer	12.3%	13.3%
Commercial	7.8%	7.9%
Real estate construction	5.0%	4.4%
Total loans	100.0%	100.0%

## Assets 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 original 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.

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 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.

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.

Interest income on originated nonaccrual loans that would have been recognized during the three months ended September 30, 2017 and 2016, if all such loans had been current in accordance with their original terms, totaled \$244,000 and \$222,000, respectively. Interest income actually recognized on these originated loans during the three months ended September 30, 2017 and 2016 was \$33,000 and \$227,000, respectively. Interest income on PNCI nonaccrual loans that would have been recognized during the three months ended September 30, 2017 and 2016, if all such loans had been current in accordance with their original terms, totaled \$90,000 and \$(42,000), respectively. Interest income actually recognized on these PNCI loans during the three months ended September 30, 2017 and 2016 was \$2,000 and \$1,000.

Interest income on originated nonaccrual loans that would have been recognized during the nine months ended September 30, 2017 and 2016, if all such loans had been current in accordance with their original terms, totaled \$617,000 and \$689,000, respectively. Interest income actually recognized on these originated loans during the nine months ended September 30, 2017 and 2016 was \$49,000 and \$256,000, respectively. Interest income on PNCI nonaccrual loans that would have been recognized during the nine months ended September 30, 2017 and 2016, if all such loans had been current in accordance with their original terms, totaled \$188,000 and \$137,000. Interest income actually recognized on these PNCI loans during the nine months ended September 30, 2017 and 2016 was \$14,000 and \$1,000.

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 set 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:

(dollars in thousands)	September 30, 2017				
	Originated	PNCI	PCI – cash basis	PCI - other	Total
Performing nonaccrual loans	\$9,642	\$1,999	\$2,160	\$5,031	\$18,832
Nonperforming nonaccrual loans	2,046	1,027	49	-	3,122
Total nonaccrual loans	11,688	3,026	2,209	5,031	21,954
Originated and PNCI loans 90 days past due and still accruing	-	-	-	-	-
Total nonperforming loans	11,688	3,026	2,209	5,031	21,954
Noncovered foreclosed assets	1,957	-	-	1,114	3,071
Covered foreclosed assets	-	-	-	-	-
Total nonperforming assets	\$13,645	\$3,026	\$2,209	\$6,145	\$25,025

U.S. government, including its agencies and its government-sponsored agencies, guaranteed portion of nonperforming loans	\$425	-	-	-	\$425
Nonperforming assets to total assets	0.29%	0.06%	0.05%	0.13%	0.54%
Nonperforming loans to total loans	0.45%	0.98%	100.0%	36.47%	0.75%
Allowance for loan losses to nonperforming loans	235%	34%	1%	5%	131%
Allowance for loan losses, unamortized loan fees, and discounts to loan principal balances owed	1.35%	2.73%	66.3%	23.29%	1.78%

The following table set 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:

(dollars in thousands)	December 31, 2016				
	Originated	PNCI	PCI – cash basis	PCI - other	Total
Performing nonaccrual loans	\$11,146	\$2,131	\$2,983	\$1,417	\$17,677
Nonperforming nonaccrual loans	1,748	703	-	-	2,451
Total nonaccrual loans	12,894	2,834	\$2,983	\$1,417	20,128
Originated loans 90 days past due and still accruing	-	-	-	-	-
Total nonperforming loans	12,894	2,834	\$2,983	\$1,417	20,128
Noncovered foreclosed assets	2,277	-	-	1,486	3,763
Covered foreclosed assets	-	-	-	223	223
Total nonperforming assets	\$15,171	\$2,834	\$2,983	\$3,126	\$24,114

U.S. government, including its agencies and its government-sponsored agencies, guaranteed portion of nonperforming loans	\$911	-	-	-	\$911
Indemnified portion of covered foreclosed assets	-	-	-	\$218	\$218
Nonperforming assets to total assets	0.34%	0.06%	0.07%	0.07%	0.53%
Nonperforming loans to total loans	0.55%	0.75%	100.00%	6.42%	0.73%
Allowance for loan losses to nonperforming loans	218%	59%	1%	189%	161%
Allowance for loan losses, unamortized loan fees, and discounts to loan principal balances owed	1.48%	2.98%	64.18%	24.44%	2.09%

### Changes in nonperforming assets during the three months ended September 30, 2017

(dollars in thousands):	Balance at September 30, 2017	New NPA	Advances/ Capitalized Costs	Pay-downs /Sales /Upgrades	Charge-offs/ Write-downs	Transfers to Foreclosed Assets	Category Changes	Balance at June 30, 2017
Real estate mortgage:								
Residential	\$3,066	\$1,144	-	\$(43)	\$(60)	-	183	\$1,842
Commercial	12,349	3,323	\$7	(486)	(20)	-	123	9,402
Consumer								
Home equity lines	3,019	137	-	(448)	(13)	-	(210)	3,553
Home equity loans	1,500	709	-	(103)	(94)	\$(42)	27	1,003
Other consumer	19	143	-	(24)	(174)	-	-	74
Commercial (C&I)	2,001	1,189	3	(332)	(291)	-	(123)	1,555
Construction:								
Residential	-	33	-	-	(33)	-	-	-
Commercial	-	-	-	-	-	-	-	-
Total nonperforming loans	21,954	6,678	10	(1,436)	(685)	(42)	-	17,429
Noncovered foreclosed assets	3,071	-	-	(325)	(135)	42	-	3,489
Total nonperforming assets	<u>\$25,025</u>	<u>\$6,678</u>	<u>\$10</u>	<u>\$(1,761)</u>	<u>\$(820)</u>	<u>-</u>	<u>-</u>	<u>\$20,918</u>

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

Nonperforming assets increased during the third quarter of 2017 by \$4,107,000 (19.6%) to \$25,025,000 at September 30, 2017 compared to \$20,918,000 at June 30, 2017. The increase in nonperforming assets during the third quarter of 2017 was primarily the result of new nonperforming loans of \$6,678,000, and advances on nonperforming loans of \$10,000, that were partially offset by sales or upgrades of nonperforming loans to performing status totaling \$1,436,000, dispositions of foreclosed assets totaling \$325,000, loan charge-offs of \$685,000, and write-downs on foreclosed assets of \$135,000.

The \$6,678,000 in new nonperforming loans during the third quarter of 2017 was comprised of increases of \$1,144,000 on three residential real estate loans, \$3,323,000 on five commercial real estate loans, \$846,000 on 10 home equity lines and loans, \$143,000 on 21 consumer loans, \$1,189,000 on 15 C&I loans, and \$33,000 on one residential construction loan.

The \$1,144,000 in new nonperforming residential real estate loans was primarily made up of one loan in the amount of \$939,000 secured by a single family property in northern California. The \$3,323,000 in new nonperforming CRE loans was primarily comprised of two loans secured by commercial office properties in northern California. The \$1,189,000 in new nonperforming C&I loans was primarily comprised of four loans within a single relationship secured by general business assets in northern California. Related charge-offs are discussed below.

#### Loan charge-offs during the three months ended September 30, 2017

In the third quarter of 2017, the Company recorded \$685,000 in loan charge-offs and \$176,000 in deposit overdraft charge-offs less \$646,000 in loan recoveries and \$55,000 in deposit overdraft recoveries resulting in \$161,000 of net charge-offs. Primary causes of the loan charges taken in the third quarter of 2017 were gross charge-offs of \$60,000 on two residential real estate loans, \$20,000 on a single commercial real estate loan, \$107,000 on six home equity lines and loans, \$174,000 on 19 other consumer loans, \$291,000 on four C&I loans and \$33,000 on a single pool of Purchased Credit Impaired residential construction loans.

Total charge-offs were comprised 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 June 30, 2017

(dollars in thousands):	Balance at June 30, 2017	New NPA	Advances/ Capitalized Costs	Pay-downs /Sales /Upgrades	Charge-offs/ Write-downs	Transfers to Foreclosed Assets	Category Changes	Balance at March 31, 2017
Real estate mortgage:								
Residential	\$1,842	\$1,097	-	\$(16)	-	-	-	\$761
Commercial	9,402	362	-	(3,085)	\$(150)	-	\$135	12,140
Consumer								
Home equity lines	3,553	396	\$360	(428)	(13)	\$(462)	-	3,700
Home equity loans	1,003	283	-	(35)	(206)	-	-	961
Other consumer	74	255	-	(6)	(190)	-	-	15
Commercial (C&I)	1,555	1,684	-	(1,139)	(764)	-	\$(135)	1,909
Construction:								
Residential	-	1,071	-	(25)	(1,071)	-	-	25
Commercial	-	-	-	-	-	-	-	-
Total nonperforming loans	17,429	5,148	360	(4,734)	(2,394)	(462)	-	19,511
Noncovered foreclosed assets	3,489	-	-	(545)	43	\$462	-	3,529
Total nonperforming assets	\$20,918	\$5,148	\$360	\$(5,279)	\$(2,351)	-	-	\$23,040

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

Nonperforming assets decreased during the second quarter of 2017 by \$2,122,000 (9.2%) to \$20,918,000 at June 30, 2017 compared to \$23,040,000 at March 31, 2017. The decrease in nonperforming assets during the second quarter of 2017 was primarily the result of sales or upgrades of nonperforming loans to performing status totaling \$4,734,000, dispositions of foreclosed assets totaling \$545,000, and loan charge-offs of \$2,394,000, that were partially offset by new nonperforming loans of \$5,148,000, advances on nonperforming loans of \$360,000, and an increase in foreclosed asset valuation of \$43,000, the net result of \$6,000 of write-downs and \$49,000 of positive adjustments to foreclosed asset valuations.

The \$5,148,000 in new nonperforming loans during the second quarter of 2017 was comprised of increases of \$1,097,000 on two residential real estate loans, \$362,000 on two commercial real estate loans, \$679,000 on 11 home equity lines and loans, \$255,000 on 27 consumer loans, \$1,684,000 on 12 C&I loans, and \$1,071,000 residential construction loans.

The \$1,097,000 in new nonperforming residential real estate loans was primarily made up of one loan in the amount of \$959,000 secured by a single family property in southern California. The \$1,684,000 in new nonperforming C&I loans was primarily comprised of one loan in the amount of \$361,000 secured by crop proceeds in northern California, and one loan in the amount of \$363,000 secured by general business assets in northern California. Also, included in these new nonperforming assets during the three months ended June 30, 2017 were residential construction loans of \$1,071,000, commercial loans of \$424,000, and commercial real estate loans of \$150,000; all of which were classified as PCI – other loans and accounted for using the pool method of accounting under ASC Topic 310-30; and for which the related pools were resolved during the three months ended June 30, 2017 resulting in these fully reserved loan balances to be deemed uncollectable and simultaneously charged off. Related charge-offs are discussed below.

#### Loan charge-offs during the three months ended June 30, 2017

In the second quarter of 2017, the Company recorded \$2,394,000 in loan charge-offs and \$118,000 in deposit overdraft charge-offs less \$377,000 in loan recoveries and \$56,000 in deposit overdraft recoveries resulting in \$2,079,000 of net charge-offs. Primary causes of the loan charges taken in the first quarter of 2017 were gross charge-offs of \$150,000 on a single pool of PCI - other commercial real estate loans, \$219,000 on five home equity lines and loans, \$190,000 on 24 other consumer loans, \$764,000 on five C&I loans and \$1,071,000 on a single pool of Purchased Credit Impaired residential construction loans.

Total charge-offs were generally comprised of individual charges of less than \$250,000 each with the exception of two during the quarter. Each of these charges was related to the resolution of a pool of Purchased Credit Impaired loans. One charge in the amount of \$424,000 was related to C&I loans secured by general business assets in northern California, and the second in the amount of \$1,071,000 was related to a pool of residential construction loans in northern California. 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 March 31, 2017

(dollars in thousands):	Balance at March 31, 2017	New NPA	Advances/ Capitalized Costs	Pay-downs /Sales /Upgrades	Charge-offs/ Write-downs	Transfers to Foreclosed Assets	Category Changes	Balance at December 31, 2016
Real estate mortgage:								
Residential	\$761	\$345	-	\$(33)	-	-		\$449
Commercial	12,140	1,712	-	(380)	-	\$(85)	-	10,893
Consumer								
Home equity lines	3,700	-	-	(1,107)	\$(71)	-	\$(59)	4,937
Home equity loans	961	199	-	(136)	(31)	-	59	870
Other consumer	15	57	-	(9)	(71)	-	-	38
Commercial (C&I)	1,909	129	-	(1,017)	(133)	-	-	2,930
Construction:								
Residential	25	14	-	-	-	-	-	11
Commercial	-	-	-	-	-	-	-	-
Total nonperforming loans	19,511	2,456	-	(2,682)	(306)	(85)	-	20,128
Noncovered foreclosed assets	3,529	-	-	(385)	66	85	-	3,763
Covered foreclosed assets	-	-	-	(223)	-	-	-	223
Total nonperforming assets	<u>\$23,040</u>	<u>\$2,456</u>	<u>-</u>	<u>\$(3,290)</u>	<u>\$240</u>	<u>-</u>	<u>-</u>	<u>\$24,114</u>

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

Nonperforming assets decreased during the first quarter of 2017 by \$1,074,000 (4.5%) to \$23,040,000 at March 31, 2017 compared to \$24,114,000 at December 31, 2016. The decrease in nonperforming assets during the first quarter of 2017 was primarily the result of sales or upgrades of nonperforming loans to performing status totaling \$2,682,000, dispositions of foreclosed assets totaling \$608,000, loan charge-offs of \$306,000, and write-downs on foreclosed assets totaling \$22,000, that were partially offset by new nonperforming loans of \$2,456,000, and an increase in foreclosed asset valuation of \$66,000, the net result of \$22,000 of write-downs and \$88,000 of positive adjustments to foreclosed asset valuations.

The \$2,456,000 in new nonperforming loans during the first quarter of 2017 was comprised of increases of \$345,000 on three residential real estate loans, \$1,712,000 on one commercial real estate loan, \$199,000 on three home equity lines and loans, \$57,000 on 10 consumer loans, \$129,000 on two C&I loans, and \$14,000 on a single residential construction loan.

The \$1,712,000 in new nonperforming commercial real estate loans was entirely comprised of one loan secured by a commercial mini storage facility in central California. Related charge-offs are discussed below.

#### Loan charge-offs during the three months ended March 31, 2017

In the first quarter of 2017, the Company recorded \$306,000 in loan charge-offs and \$103,000 in deposit overdraft charge-offs less \$406,000 in loan recoveries and \$74,000 in deposit overdraft recoveries resulting in \$71,000 of net recoveries. Primary causes of the loan charges taken in the first quarter of 2017 were gross charge-offs of \$102,000 on five home equity lines and loans, \$71,000 on 12 other consumer loans, and \$133,000 on five C&I loans.

Total charge-offs were generally comprised 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 original 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.

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.

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, home affordability, 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 loans that have not yet been identified as impaired, management considered the volume and severity of past due loans, and
- with respect to concentrations within the portfolio, management considered the risk introduced by concentrations among specific segments of the portfolio, underlying collateral types, borrowers or group of borrowers, and geographic areas.

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.

Acquired loans are valued as of their acquisition date in accordance with 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 allowance for loan losses as of the dates indicated:

(dollars in thousands)	September 30, 2017	December 31, 2016
Allowance for originated and PNCI loan losses:		
Specific allowance	\$2,140	\$2,046
Formula allowance	16,469	17,485
Environmental factors allowance	9,851	10,275
Allowance for originated and PNCI loan losses	28,460	29,806
Allowance for PCI loan losses	287	2,697
Allowance for loan losses	<u>\$28,747</u>	<u>\$32,503</u>
Allowance for loan losses to loans	0.98%	1.18%

For additional information regarding the allowance for loan losses, including changes in specific, formula, and environmental factors allowance categories, see “*Provision for Loan Losses*” at “*Results of Operations*” and “*Allowance for Loan Losses*” above. Based on the current conditions of the loan portfolio, management believes that the \$28,747,000 allowance for loan losses at September 30, 2017 is adequate to absorb probable incurred 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 as of the dates indicated:

(in thousands)	September 30,	December 31,
	2017	2016
Real estate mortgage	\$13,588	\$14,264
Consumer	8,302	10,312
Commercial	4,802	5,831
Real estate construction	2,055	2,096
Total allowance for loan losses	<u>\$28,747</u>	<u>\$32,503</u>

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 as of the dates indicated:

	September 30,	December 31,
	2017	2016
Real estate mortgage	47.3%	43.9%
Consumer	28.9%	31.7%
Commercial	16.7%	17.9%
Real estate construction	7.1%	6.5%
Total allowance for loan losses	<u>100.0%</u>	<u>100.0%</u>

The following table summarizes the allocation of the allowance for loan losses as a percentage of the total loans for each loan category as of the dates indicated:

	September 30,	December 31,
	2017	2016
Real estate mortgage	0.62%	0.68%
Consumer	2.30%	2.80%
Commercial	2.11%	2.69%
Real estate construction	1.39%	1.71%
Total allowance for loan losses	<u>0.98%</u>	<u>1.18%</u>



**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 period indicated (dollars in thousands):

(dollars in thousands):	Balance at September 30, 2017	New NPA	Advances/ Capitalized Costs/Other	Sales	Valuation Adjustments	Transfers from Loans	Category Changes	Balance at June 30, 2017
Noncovered:								
Land & Construction	\$1,405	-	-	-	\$(92)	-	-	\$1,497
Residential real estate	1,386	-	-	\$(326)	(42)	42	-	1,712
Commercial real estate	280	-	-	-	-	-	-	280
Total noncovered	3,071	-	-	(326)	(134)	42	-	3,489
Total foreclosed assets	<u>\$3,071</u>	-	-	<u>\$(326)</u>	<u>\$(134)</u>	<u>\$42</u>	-	<u>\$3,489</u>

(dollars in thousands):	Balance at June 30, 2017	New NPA	Advances/ Capitalized Costs/Other	Sales	Valuation Adjustments	Transfers from Loans	Category Changes	Balance at March 31, 2017
Noncovered:								
Land & Construction	\$1,497	-	-	-	-	-	-	\$1,497
Residential real estate	1,712	-	-	-	\$(6)	\$511	-	1,207
Commercial real estate	280	-	-	\$(545)	(88)	88	-	825
Total noncovered	3,489	-	-	(545)	(94)	599	-	3,529
Total foreclosed assets	<u>\$3,489</u>	-	-	<u>\$(545)</u>	<u>\$(94)</u>	<u>\$599</u>	-	<u>\$3,529</u>

(dollars in thousands):	Balance at March 31, 2017	New NPA	Advances/ Capitalized Costs/Other	Sales	Valuation Adjustments	Transfers from Loans	Category Changes	Balance at December 31, 2016
Noncovered:								
Land & Construction	\$1,497	-	-	\$(15)	-	-	-	\$1,512
Residential real estate	1,207	-	-	(234)	-	-	-	1,441
Commercial real estate	825	-	-	(136)	\$66	\$85	-	810
Total noncovered	3,529	-	-	(385)	66	85	-	3,763
Covered:								
Land & Construction	-	-	-	-	-	-	-	-
Residential real estate	-	-	-	(223)	-	-	-	223
Commercial real estate	-	-	-	-	-	-	-	-
Total covered	-	-	-	(223)	-	-	-	223
Total foreclosed assets	<u>\$3,529</u>	-	-	<u>\$(608)</u>	<u>\$66</u>	<u>\$85</u>	-	<u>\$3,986</u>

**Premises and Equipment**

Premises and equipment were comprised of:

	September 30, 2017	December 31, 2016
	(In thousands)	
Land & land improvements	\$10,021	\$9,522
Buildings	43,860	42,345
Furniture and equipment	34,530	31,428
	88,411	83,295
Less: Accumulated depreciation	(39,892)	(37,412)
	48,519	45,883
Construction in progress	6,476	2,523
Total premises and equipment	<u>\$54,995</u>	<u>\$48,406</u>

During the nine months ended September 30, 2017, premises and equipment increased \$6,589,000 due to purchases of \$10,874,000, that were partially offset by depreciation of \$4,224,000 and disposals of premises and equipment with net book value of \$61,000.

**Intangible Assets**

Intangible assets at were comprised of the following as of the dates indicated:

(In thousands)	September 30, 2017	December 31, 2016
Core-deposit intangible	\$5,513	\$6,563
Goodwill	64,311	64,311
Total intangible assets	<u>\$69,824</u>	<u>\$70,874</u>

The core-deposit intangible assets resulted from the Bank's acquisition of three bank branches from Bank of America on March 18, 2016, North Valley Bancorp in 2014, Citizens in 2011, and Granite in 2010. The goodwill intangible asset includes \$849,000 from the acquisition of three bank branches from Bank of America on March 18, 2016, \$47,943,000 from the North Valley Bancorp acquisition in 2014, and \$15,519,000 from the North State National Bank acquisition in 2003. Amortization of core deposit intangible assets amounting to \$339,000

and \$359,000 was recorded during the three months ended September 30, 2017 and 2016, respectively. Amortization of core deposit intangible assets amounting to \$1,050,000 and \$1,017,000 was recorded during the nine months ended September 30, 2017 and 2016, respectively.

#### Investment in Low Income Housing Tax Credit Funds

During the three and nine month periods ended September 30, 2017, the Company's investment in low income housing tax credit funds, recorded in other assets, decreased \$366,000 and \$1,012,000, respectively, to \$17,453,000 due amortization of such investments. The Company's investment in low income housing tax credit funds is recorded in other assets. During the three and nine month periods ended September 30, 2017, the Company made capital contributions of \$903,000 and \$3,737,000, respectively, to several of its five existing low income housing tax credit fund investments reducing its commitment for future capital contributions to \$11,439,000 at September 30, 2017. This commitment for low income housing tax credit funds is recorded in other liabilities.

#### Deposits

During the nine months ended September 30, 2017, the Company's deposits increased \$31,896,000 (0.8%) to \$3,927,456,000. Included in the September 30, 2017 and December 31, 2016 certificate of deposit balances are \$50,000,000 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. See Note 13 to the condensed consolidated financial statements at Item 1 of Part I of this report for more information about the Company's deposits.

#### Long-Term Debt

See Note 16 to the condensed consolidated financial statements at Item 1 of Part I of this report for information about the Company's other borrowings, including long-term debt.

#### Junior Subordinated Debt

See Note 17 to the condensed consolidated financial statements at Item 1 of Part I of this report for information about the Company's junior subordinated debt.

#### Off-Balance Sheet Arrangements

See Note 18 to the condensed consolidated financial statements at Item 1 of Part I of this report for information about the Company's commitments and contingencies including off-balance-sheet arrangements.

#### Capital Resources

The current and projected capital position of the Company and the impact of capital plans and long-term strategies are reviewed regularly by Management.

The Company adopted and announced 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. During the nine months ended September 30, 2017, the Company did not repurchase any shares under this plan. This plan has no stated expiration date for the repurchases. As of September 30, 2017, the Company had repurchased 166,600 shares under this plan, which left 333,400 shares available for repurchase under the plan. Shares that are repurchased in accordance with the provisions of a Company stock option plan or equity compensation plan are not counted against the number of shares repurchased under the repurchase plan adopted on August 21, 2007.

The Company's primary capital resource is shareholders' equity, which was \$506,733,000 at September 30, 2017. This amount represents an increase of \$29,386,000 (6.2%) from December 31, 2016, the net result of comprehensive income for the period of \$40,866,000, the effect of equity compensation vesting of \$1,184,000, and the exercise of stock options of \$2,418,000, that were partially offset by dividends paid of \$11,228,000, and repurchase of common stock of \$3,854,000. The Company's ratio of equity to total assets was 10.9% and 10.6% as of September 30, 2017 and December 31, 2016, respectively. We believe that the Company and the Bank were in compliance with applicable minimum capital requirements set forth in the final Basel III Capital rules as of September 30, 2017. The following summarizes the Company's ratios of capital to risk-adjusted assets as of the dates indicated:

	September 30, 2017		December 31, 2016	
	Ratio	Minimum Regulatory Requirement	Ratio	Minimum Regulatory Requirement
Total capital	14.42%	9.250%	14.77%	8.625%
Tier I capital	13.55%	7.250%	13.74%	6.625%
Common equity Tier 1 capital	12.06%	5.750%	12.17%	5.125%
Leverage	10.98%	4.000%	10.62%	4.000%

See Note 19 and Note 29 to the condensed consolidated financial statements at Item 1 of Part I of this report for additional information about the Company's capital resources.



## **Liquidity**

The Bank's principal source of asset liquidity is cash at Federal Reserve and other banks and marketable investment securities available for sale. At September 30, 2017, cash at Federal Reserve and other banks in excess of reserve requirements and investment securities available for sale totaled \$787,044,000, or 16.9% of total assets, representing an increase of \$9,382,000 (1.2%) from \$777,662,000, or 17.2% of total assets at December 31, 2016. This increase in cash and securities available for sale is due mainly to increases in deposits and other borrowings, cash from operations and the maturity of held to maturity securities that were substantially offset by loan growth during the nine months ended September 30, 2017. The Company's profitability during the first nine months of 2017 generated cash flows from operations of \$45,817,000 compared to \$38,884,000 during the first nine months of 2016. Maturities of investment securities produced cash inflows of \$111,615,000 during the nine months ended September 30, 2017 compared to \$131,387,000 during the nine months ended September 30, 2016. During the nine months ended September 30, 2017, the Company invested in securities totaling \$195,465,000 and net loan principal increases of \$174,914,000 compared to \$160,787,000 invested in securities and \$220,869,000 net loan principal increases, respectively, during the first nine months of 2016. Proceeds from the sale of loans other than loans originated for sale accounted for \$32,029,000 of investing sources of funds during the nine months ended September 30, 2016. Proceeds from the sale of foreclosed assets accounted for \$1,787,000 and \$3,375,000 of investing sources of funds during the nine months ended September 30, 2017 and 2016, respectively. Proceeds from the sale of premises held for sale accounted for \$3,338,000 of investing sources of funds during the nine months ended September 30, 2017. The acquisition of three bank branches and the assumption of \$161,231,000 of associated deposit balances, from Bank of America on March 18, 2016, accounted for \$156,316,000 of investing sources of funds during the nine months ended September 30, 2016. These changes in investment and loan balances, proceeds from sale of foreclosed assets and premises held for sale, and the acquisition of branches and associated deposits, contributed to net cash used by investing activities of \$263,864,000 during the nine months ended September 30, 2017, compared to net cash provided by investing activities of \$67,366,000 during the nine months ended September 30, 2016. Financing activities provided net cash of \$100,469,000 during the nine months ended September 30, 2017, compared to net cash used by financing activities of \$40,109,000 during the nine months ended September 30, 2016. Deposit balance increases accounted for \$31,896,000 and \$43,515,000 of financing uses of funds during the nine months ended September 30, 2017 and 2016, respectively. Net changes in other borrowings accounted for \$81,237,000 and \$6,907,000 of financing sources of funds during the nine months ended September 30, 2017 and 2016, respectively. Dividends paid used \$11,228,000 and \$10,265,000 of cash during the nine months ended September 30, 2017 and 2016, respectively. The Company's liquidity is dependent on dividends received from the Bank. Dividends from the Bank are subject to certain regulatory restrictions.

## **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

The Company's assessment of market risk as of September 30, 2017 indicates there are no material changes in the quantitative and qualitative disclosures from those in our Annual Report on Form 10-K for the year ended December 31, 2016

## **Item 4. Controls and Procedures**

The Company's management, including its Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of the Company's disclosure controls and procedures as of September 30, 2017. Disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), are controls and procedures designed to reasonably assure that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported on a timely basis. Disclosure controls are also designed to reasonably assure that such information is accumulated and communicated to the Company's management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Based upon their evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of September 30, 2017.

During the three months ended September 30, 2017, there were no changes in our internal controls or in other factors that have materially affected or are reasonably likely to materially affect our internal controls over financial reporting.

## PART II – OTHER INFORMATION

### Item 1 – Legal Proceedings

Due to the nature of our business, we are involved in legal proceedings that arise in the ordinary course of our business. While the outcome of these matters is currently not determinable, we do not expect that the ultimate costs to resolve these matters will have a material adverse effect on our consolidated financial position, results of operations, or cash flows.

See Note 18 to the condensed consolidated financial statements at Item 1 of Part I of this report, for a discussion of the Company's involvement in litigation.

### Item 1A – Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed under “Part I—Item 1A—Risk Factors” in our Form 10-K for the year ended December 31, 2016 which are incorporated by reference herein. These factors could materially adversely affect our business, financial condition, liquidity, results of operations and capital position, and could cause our actual results to differ materially from our historical results or the results contemplated by the forward-looking statements contained in this report.

### Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds

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 three months ended September 30, 2017:

Period	(a) Total number of shares purchased <sup>(1)</sup>	(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 <sup>(2)</sup>
July 1-31, 2017	-	-	-	333,400
Aug. 1-31, 2017	9,672	\$36.34	-	333,400
Sep. 1-30, 2017	12,066	\$34.50	-	333,400
Total	21,738	\$35.32	-	333,400

- (1) Includes shares purchased by the Company's Employee Stock Ownership Plan and pursuant to various other equity incentive plans. See Note 19 to the condensed consolidated financial statements at Item 1 of Part I of this report, for a discussion of the Company's stock repurchased under equity compensation plans.
- (2) Does not include shares that may be purchased by the Company's Employee Stock Ownership Plan and pursuant to various other equity incentive plans.

EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Exhibit</u>
3.1	Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to TriCo’s Current Report on Form 8-K filed on March 17, 2009).
3.2	Bylaws of TriCo, as amended (incorporated by reference to Exhibit 3.1 to TriCo’s Current Report on Form 8-K filed February 17, 2011).
4.1	Instruments defining the rights of holders of the long-term debt securities of the TriCo and its subsidiaries are omitted pursuant to section (b)(4)(iii)(A) of Item 601 of Regulation S-K. TriCo hereby agrees to furnish copies of these instruments to the Securities and Exchange Commission upon request.
10.1*	Form of Change of Control Agreement among TriCo, Tri Counties Bank and each of Dan Bailey, Craig Carney, John Fleshood, Richard O’Sullivan, and Thomas Reddish (incorporated by reference to Exhibit 10.2 to TriCo’s Current Report on Form 8-K filed on July 23, 2013).
10.2*	TriCo’s 2001 Stock Option Plan, as amended (incorporated by reference to Exhibit 10.7 to TriCo’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2005).
10.3*	TriCo’s 2009 Equity Incentive Plan, as amended (incorporated by reference to Exhibit 10.2 to TriCo’s Current Report on Form 8-K filed April 3, 2013).
10.4*	Amended Employment Agreement between TriCo and Richard Smith dated as of March 28, 2013 (incorporated by reference to Exhibit 10.1 to TriCo’s Current Report on Form 8-K filed April 3, 2013).
10.5*	Transaction Bonus Agreement between TriCo Bancshares and Richard P. Smith dated as of August 7, 2014 (incorporated by reference to Exhibit 10.4 to TriCo’s Form 8-K filed on August 13, 2014).
10.6*	Tri Counties Bank Executive Deferred Compensation Plan restated April 1, 1992, and January 1, 2005 (incorporated by reference to Exhibit 10.9 to TriCo’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2005).
10.7*	Tri Counties Bank Deferred Compensation Plan for Directors effective January 1, 2005 (incorporated by reference to Exhibit 10.10 to TriCo’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2005).
10.8*	2005 Tri Counties Bank Deferred Compensation Plan for Executives and Directors effective January 1, 2005 (incorporated by reference to Exhibit 10.11 to TriCo’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2005).
10.9*	Tri Counties Bank Supplemental Retirement Plan for Directors dated September 1, 1987, as restated January 1, 2001, and amended and restated January 1, 2004 (incorporated by reference to Exhibit 10.12 to TriCo’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2004).
10.10*	2004 TriCo Bancshares Supplemental Retirement Plan for Directors effective January 1, 2004 (incorporated by reference to Exhibit 10.13 to TriCo’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2004).
10.11*	Tri Counties Bank Supplemental Executive Retirement Plan effective September 1, 1987, as amended and restated January 1, 2004 (incorporated by reference to Exhibit 10.14 to TriCo’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2004).
10.12*	2004 TriCo Bancshares Supplemental Executive Retirement Plan effective January 1, 2004 (incorporated by reference to Exhibit 10.15 to TriCo’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2004).
10.13*	Form of Joint Beneficiary Agreement effective March 31, 2003 between Tri Counties Bank and each of George Barstow, Dan Bay, Ron Bee, Craig Carney, Robert Elmore, Greg Gill, Richard Miller, Richard O’Sullivan, Thomas Reddish, Jerald Sax, and Richard Smith (incorporated by reference to Exhibit 10.14 to TriCo’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).
10.14*	Form of Joint Beneficiary Agreement effective March 31, 2003 between Tri Counties Bank and each of Don Amaral, William Casey, Craig Compton, John Hasbrook, Michael Koehnen, Donald Murphy, Carroll Taresh, and Alex Vereschagin (incorporated by reference to Exhibit 10.15 to TriCo’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).
10.15*	Form of Tri Counties Bank Executive Long Term Care Agreement effective June 10, 2003 between Tri Counties Bank and each of Craig Carney, Richard Miller, Richard O’Sullivan, and Thomas Reddish (incorporated by reference to Exhibit 10.16 to TriCo’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).
10.16*	Form of Tri Counties Bank Director Long Term Care Agreement effective June 10, 2003 between Tri Counties Bank and each of Don Amaral, William Casey, Craig Compton, John Hasbrook, Michael Koehnen, Carroll Taresh, and Alex Vereschagin (incorporated by reference to Exhibit 10.17 to TriCo’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).
10.17*	Form of Indemnification Agreement between TriCo and its directors and executive officers (incorporated by reference to Exhibit 10.1 to TriCo’s Current Report on Form 8-K filed September 10, 2013).
10.18*	Form of Indemnification Agreement between Tri Counties Bank its directors and executive officers (incorporated by reference to Exhibit 10.2 to TriCo’s Current Report on Form 8-K filed September 10, 2013).
10.19*	Form of Restricted Stock Unit Agreement and Grant Notice for Non-Employee Executives pursuant to TriCo’s 2009 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to TriCo’s Current Report on Form 8-K filed November 14, 2014).

**Item 6 – Exhibits (continued)**

- 10.21\* Form of Restricted Stock Unit Agreement and Grant Notice for Directors pursuant to TriCo's 2009 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to TriCo's Current Report on Form 8-K filed November 14, 2014).
- 10.22\* Form of Performance Award Agreement and Grant Notice pursuant to TriCo's 2009 Equity Incentive Plan (incorporated by reference to Exhibit 10.3 to TriCo's Current Report on Form 8-K filed August 13, 2014).
- 10.23\* John Fleshood Offer Letter dated November 3, 2016 (incorporated by reference to Exhibit 10.1 to TriCo's Current Report on Form 8-K filed on November 30, 2016).
- 10.24\* Amendment to John Fleshood Offer Letter dated December 19, 2016 (incorporated by reference to Exhibit 10.1 to TriCo's Current Report on Form 8-K filed on November 30, 2016).
  
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of CEO
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of CFO
- 32.1 Section 1350 Certification of CEO
- 32.2 Section 1350 Certification of CFO
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document

\* Management contract or compensatory plan or arrangement

**SIGNATURES**

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

**TRICO BANCSHARES**  
(Registrant)

Date: November 9, 2017

/s/ Thomas J. Reddish

Thomas J. Reddish

Executive Vice President and Chief Financial Officer

(Duly authorized officer and principal accounting and financial officer)

## EXHIBITS

### Exhibit 31.1

#### Rule 13a-14(a)/15d-14(a) Certification of CEO

I, Richard P. Smith, certify that;

1. I have reviewed this report on Form 10-Q of TriCo Bancshares;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial data; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2017

/s/ Richard P. Smith  
Richard P. Smith  
President and Chief Executive Officer

Rule 13a-14(a)/15d-14(a) Certification of CFO

I, Thomas J. Reddish, certify that;

1. I have reviewed this report on Form 10-Q of TriCo Bancshares;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial data; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2017

/s/ Thomas J. Reddish  
Thomas J. Reddish  
Executive Vice President and Chief Financial Officer

Exhibit 32.1

Section 1350 Certification of CEO

In connection with the Quarterly Report of TriCo Bancshares (the “Company”) on Form 10-Q for the period ended September 30, 2017 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Richard P. Smith, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Richard P. Smith

Richard P. Smith

President and Chief Executive Officer

A signed original of this written statement required by Section 906 has been provided to TriCo Bancshares and will be retained by TriCo Bancshares and furnished to the Securities and Exchange Commission or its staff upon request.

Exhibit 32.2

Section 1350 Certification of CFO

In connection with the Quarterly Report of TriCo Bancshares (the “Company”) on Form 10-Q for the period ended September 30, 2017 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Thomas J. Reddish, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Thomas J. Reddish

Thomas J. Reddish

Executive Vice President and Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to TriCo Bancshares and will be retained by TriCo Bancshares and furnished to the Securities and Exchange Commission or its staff upon request.