

UNITED SECURITY BANCSHARES  
Form 10-Q  
November 09, 2007

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

**FORM 10-Q**

- x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2007.
- o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Commission file number: 000-32987

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

CALIFORNIA  
(State or other jurisdiction of  
incorporation or organization)

91-2112732  
(I.R.S. Employer  
Identification No.)

2126 Inyo Street, Fresno, California  
(Address of principal executive offices)

93721  
(Zip Code)

Registrants telephone number, including area code (559) 248-4943

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

Yes x No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

Aggregate market value of the Common Stock held by non-affiliates as of the last business day of the registrant's most recently completed second fiscal quarter - June 30, 2007: \$176,229,651

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

Common Stock, no par  
value  
(Title of Class)

Shares outstanding as of October 31, 2007: 11,905,438



**TABLE OF CONTENTS**

Facing Page		
Table of Contents		
<b>PART I. Financial Information</b>		<b>1</b>
Item 1.	Financial Statements	1
	Consolidated Balance Sheets	1
	Consolidated Statements of Income and Comprehensive Income	2
	Consolidated Statements of Changes in Shareholders' Equity	3
	Consolidated Statements of Cash Flows	4
	Notes to Consolidated Financial Statements	5
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	19
	Overview	19
	Results of Operations	21
	Financial Condition	26
	Asset/Liability Management - Liquidity and Cash Flow	32
	Regulatory Matters	34
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	35
	Interest Rate Sensitivity and Market Risk	35
Item 4.	Controls and Procedures	37
<b>PART II. Other Information</b>		<b>38</b>
Item 1.	Legal Proceedings	38
Item 1A.	Risk Factors	38
Item 2.	Unregistered Sales of Equity Securities and Use of Proceed	38
Item 3.	Defaults Upon Senior Securities	39
Item 4.	Submission of Matters to a Vote of Security Holders	39
Item 5.	Other Information	39
Item 6.	Exhibits	39
Signatures		40

**PART I. Financial Information****United Security Bancshares and Subsidiaries  
Consolidated Balance Sheets - (unaudited)  
September 30, 2007 and December 31, 2006**

<i>(in thousands except shares)</i>	September 30, 2007	December 31, 2006
<b>Assets</b>		
Cash and due from banks	\$ 27,111	\$ 28,771
Federal funds sold	1,770	14,297
Cash and cash equivalents	28,881	43,068
Interest-bearing deposits in other banks	5,255	7,893
Investment securities available for sale at fair value	88,657	83,366
Loans and leases	625,948	500,568
Unearned fees	(1,857)	(999)
Allowance for credit losses	(10,121)	(8,365)
Net loans	613,970	491,204
Accrued interest receivable	5,041	4,237
Premises and equipment - net	15,789	15,302
Other real estate owned	2,482	1,919
Intangible assets	4,525	2,264
Goodwill	8,835	750
Cash surrender value of life insurance	13,719	13,668
Investment in limited partnership	3,240	3,564
Deferred income taxes	6,194	5,307
Other assets	6,389	5,772
<b>Total assets</b>	<b>\$ 802,977</b>	<b>\$ 678,314</b>
<b>Liabilities &amp; Shareholders' Equity</b>		
<b>Liabilities</b>		
Deposits		
Noninterest bearing	\$ 152,787	\$ 159,002
Interest bearing	516,741	428,125
Total deposits	669,528	587,127
Federal funds purchased	15,400	0
Other borrowings	10,000	0
Accrued interest payable	2,207	2,477
Accounts payable and other liabilities	8,754	7,204
Junior subordinated debentures (at fair value 9/30/07)	13,554	15,464
Total liabilities	719,443	612,272
<b>Shareholders' Equity</b>		
Common stock, no par value 20,000,000 shares authorized, 11,914,447 and 11,301,113 issued and outstanding, in 2007 and 2006, respectively	33,487	20,448
Retained earnings	50,791	46,884
Accumulated other comprehensive loss	(744)	(1,290)
Total shareholders' equity	83,534	66,042
<b>Total liabilities and shareholders' equity</b>	<b>\$ 802,977</b>	<b>\$ 678,314</b>

See notes to consolidated financial statements

1

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**United Security Bancshares and Subsidiaries**  
**Consolidated Statements of Income and Comprehensive Income (unaudited)**

<i>(In thousands except shares and EPS)</i>	Quarter Ended Sept 30,		Nine Months Ended Sept 30,	
	2007	2006	2007	2006
<b>Interest Income:</b>				
Loans, including fees	\$ 13,633	\$ 11,461	\$ 39,542	\$ 31,136
Investment securities - AFS - taxable	949	808	2,882	2,450
Investment securities - AFS - nontaxable	27	27	81	81
Federal funds sold	38	170	183	599
Interest on deposits in other banks	66	82	223	243
Total interest income	14,713	12,548	42,911	34,509
<b>Interest Expense:</b>				
Interest on deposits	4,894	3,508	13,482	8,834
Interest on other borrowings	600	491	1,641	1,215
Total interest expense	5,494	3,999	15,123	10,049
<b>Net Interest Income Before Provision for Credit Losses</b>				
<b>Provision for Credit Losses</b>	9,219	8,549	27,788	24,460
<b>Provision for Credit Losses</b>	1,950	276	2,360	639
<b>Net Interest Income</b>	7,269	8,273	25,428	23,821
<b>Noninterest Income:</b>				
Customer service fees	1,191	905	3,503	2,905
Gain on sale of other real estate owned	12	11	35	38
Gain on proceeds from bank-owned life insurance	264	5	483	482
Gain (loss) on swap ineffectiveness	12	53	44	(94)
Gain on fair value of financial liabilities	2,121	0	2,234	0
Gain on sale of investment in correspondent bank stock	0	0	0	1,877
Gain on sale of fixed assets	1	1,011	2	1,012
Shared appreciation income	10	0	34	0
Other	408	346	1,219	912
Total noninterest income	4,019	2,331	7,554	7,132
<b>Noninterest Expense:</b>				
Salaries and employee benefits	2,490	2,308	7,972	7,118
Occupancy expense	922	656	2,662	1,859
Data processing	90	95	326	372
Professional fees	485	244	1,251	664
Director fees	73	57	201	167
Amortization of intangibles	278	134	740	403
Correspondent bank service charges	138	53	343	153
Loss on California tax credit partnership	107	110	324	330
OREO expense	43	870	118	1,804
Other	666	533	2,072	1,774
Total noninterest expense	5,292	5,060	16,009	14,644

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<b>Income Before Taxes on Income</b>	5,996		5,544		16,973		16,309
<b>Provision for Taxes on Income</b>	2,339		2,083		6,405		5,922
<b>Net Income</b>	\$ 3,657	\$	3,461	\$	10,568	\$	10,387
<b>Other comprehensive income, net of tax:</b>							
Unrealized gain on available for sale securities, interest rate swap, and past service costs of employee benefit plans - net income tax of \$314, \$138, \$364 and \$263							
	471		391		546		453
<b>Comprehensive Income</b>	\$ 4,128	\$	3,852	\$	11,114	\$	10,840
<b>Net Income per common share</b>							
Basic	\$ 0.31	\$	0.31	\$	0.89	\$	0.91
Diluted	\$ 0.31	\$	0.30	\$	0.88	\$	0.91
<b>Shares on which net income per common shares were based</b>							
Basic	11,931,166		11,337,694		11,938,849		11,358,351
Diluted	11,951,823		11,455,145		11,982,576		11,476,272

See notes to consolidated financial statements

**United Security Bancshares and Subsidiaries**  
**Consolidated Statements of Changes in Shareholders' Equity**  
**Periods Ended September 30, 2007**

	Common stock	Common stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
<i>(In thousands except shares)</i>	Number of Shares	Amount			
<b>Balance January 1, 2006</b>	11,361,118	\$ 22,084	\$ 38,682	\$ (1,752)	\$ 59,014
Director/Employee stock options exercised	46,000	318			318
Tax benefit of stock options exercised		201			201
Net changes in unrealized loss on available for sale securities (net of income tax of \$158)				237	237
Net changes in unrealized loss on interest rate swaps (net of income tax of \$105)				216	216
Dividends on common stock (\$0.33 per share)			(3,746)		(3,746)
Repurchase and cancellation of common shares	(97,420)	(2,177)			(2,177)
Stock-based compensation expense		175			175
Net Income			10,387		10,387
<b>Balance September 30, 2006 (Unaudited)</b>	11,309,698	20,601	45,323	(1,299)	64,625
Director/Employee stock options exercised	2,000	17			17
Tax benefit of stock options exercised		17			17
Net changes in unrealized loss on available for sale securities (net of income tax of \$84)				126	126
Net changes in unrealized loss on interest rate swaps (net of income tax of \$35)				52	52
Net changes in unrecognized past service Cost on employee benefit plans (net of income tax benefit of \$112)				(169)	(169)
Dividends on common stock (\$0.125 per share)			(1,411)		(1,411)
Repurchase and cancellation of common shares	(10,585)	(260)			(260)
Stock-based compensation expense		73			73
Net Income			2,972		2,972
<b>Balance December 31, 2006</b>	11,301,113	20,448	46,884	(1,290)	66,042
	90,000	510			510



Director/Employee stock options  
exercised

Net changes in unrealized loss on available for sale securities (net of income tax of \$234)			350	350
Net changes in unrealized loss on interest rate swaps (net of income tax of \$88)			133	133
Net changes in unrecognized past service Cost on employee benefit plans (net of income tax of \$42)			63	63
Dividends on common stock (\$0.375 per share)			(4,518)	(4,518)
Repurchase and cancellation of common shares	(453,077)	(9,148)		(9,152)
Issuance of shares for business combination	976,411	21,537		21,541
Stock-based compensation expense		140		140
Cumulative effect of adoption of SFAS No. 159 (net income tax benefit of \$613)			(845)	(845)
Cumulative effect of adoption of FIN48			(1,298)	(1,298)
Net Income			10,568	10,568
<b>Balance September 30, 2007 (Unaudited)</b>	11,914,447 \$	33,487 \$	50,791 \$	(744)\$ 83,534

See notes to consolidated financial statements

**United Security Bancshares and Subsidiaries**  
**Consolidated Statements of Cash Flows (unaudited)**

<i>(In thousands)</i>	Nine Months Ended September 30,	
	2007	2006
<b>Cash Flows From Operating Activities:</b>		
Net income	\$ 10,568	\$ 10,387
Adjustments to reconcile net earnings to cash provided by operating activities:		
Provision for credit losses	2,360	639
Depreciation and amortization	1,954	1,216
Amortization of investment securities	(79)	(44)
Increase in accrued interest receivable	(454)	(877)
Decrease in accrued interest payable	(92)	(53)
Increase in unearned fees	627	228
Increase (decrease) in income taxes payable	849	(191)
Excess tax benefits from stock-based payment arrangements	0	(1)
Stock-based compensation expense	140	175
Decrease in accounts payable and accrued liabilities	734	141
Gain on sale of correspondent bank stock	0	(1,877)
Gain on sale of other real estate owned	(35)	(38)
(Gain) loss on swap ineffectiveness	(44)	94
Gain on sale of assets	(2)	(1,012)
Income from life insurance proceeds	(483)	(482)
(Increase) decrease in surrender value of life insurance	(52)	216
Gain on fair value option of financial liabilities	(2,121)	0
Loss on limited partnership interest	324	330
Net decrease in other assets	578	2,496
Net cash provided by operating activities	14,772	11,347
<b>Cash Flows From Investing Activities:</b>		
Net decrease (increase) in interest-bearing deposits with banks	2,638	(176)
Purchases of available-for-sale securities	(19,178)	0
Maturities and calls of available-for-sale securities	21,965	5,640
Net redemption of correspondent bank stock	255	51
Premiums paid on life insurance	0	(227)
Net increase in loans	(63,815)	(83,513)
Cash and equivalents received in bank acquisition	6,373	0
Proceeds from sale of correspondent bank stock	0	2,607
Proceeds from sales of foreclosed assets	30	1,946
Proceeds from sales of premises and equipment	0	1,499
(Expenditures) proceeds from settlement of other real estate owned	(453)	2,476
Capital expenditures for premises and equipment	(973)	(3,432)
Net cash used in investing activities	(53,158)	(73,129)
<b>Cash Flows From Financing Activities:</b>		
Net (decrease) increase in demand deposit and savings accounts	(49,882)	26,863
Net increase in certificates of deposit	62,683	16,804
Net increase in federal funds purchased	15,400	0
Net increase in FHLB borrowings	10,000	0

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Redemption of junior subordinated debt	(15,923)	0
Proceeds from issuance of junior subordinated debt	15,000	0
Director/Employee stock options exercised	510	318
Excess tax benefits from stock-based payment arrangements	0	1
Repurchase and retirement of common stock	(9,148)	(2,177)
Payment of dividends on common stock	(4,441)	(3,637)
Net cash provided by financing activities	24,199	38,172
<b>Net decrease in cash and cash equivalents</b>	<b>(14,187)</b>	<b>(23,610)</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>43,068</b>	<b>63,030</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$ 28,881</b>	<b>\$ 39,420</b>

See notes to consolidated financial statements

**United Security Bancshares and Subsidiaries - Notes to Consolidated Financial Statements - (Unaudited)****1. Organization and Summary of Significant Accounting and Reporting Policies**

The consolidated financial statements include the accounts of United Security Bancshares, and its wholly owned subsidiary United Security Bank (the "Bank") and two bank subsidiaries, USB Investment Trust (the "REIT") and United Security Emerging Capital Fund, (collectively the "Company" or "USB"). Intercompany accounts and transactions have been eliminated in consolidation.

On February 16, 2007, the Company completed its merger with Legacy Bank, N.A., located in Campbell, California, with the acquisition of 100 percent of Legacy's outstanding common shares. At merger, Legacy Bank's one branch was merged with and into United Security Bank, a wholly owned subsidiary of the Company. The total value of the merger transaction was \$21.5 million, and the shareholders of Legacy Bank received merger consideration consisting of 976,411 shares of common stock of the Company. The merger transaction was accounted for as a purchase transaction, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Legacy Bank based on the fair value of those assets and liabilities. The net of assets acquired and liabilities assumed totaled approximately \$8.6 million at the date of the merger. Fair value of Legacy assets and liabilities acquired, and resultant goodwill, has been determined. (See Note 15 to the Company's consolidated financial statements contained herein for details of the merger).

These unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information on a basis consistent with the accounting policies reflected in the audited financial statements of the Company included in its Annual Report on Form 10-K for the year ended December 31, 2006. These interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of a normal recurring nature) considered necessary for a fair presentation have been included. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for any other interim period or for the year as a whole. Certain reclassifications have been made to the 2006 financial statements to conform to the classifications used in 2007. None of these reclassifications were material.

**2. Investment Securities Available for Sale**

Following is a comparison of the amortized cost and approximate fair value of securities available for sale as of September 30, 2007 and December 31, 2006:

<i>(In thousands)</i>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
<b><u>September 30, 2007:</u></b>				
U.S. Government agencies	\$ 73,740	\$ 96	\$ (657)	\$ 73,179
U.S. Government agency collateralized mortgage obligations	14	0	0	14
Obligations of state and political subdivisions	2,227	50	0	2,277
Other investment securities	13,716	0	(529)	13,187
	\$ 89,697	\$ 146	\$ (1,186)	\$ 88,657
<b><u>December 31, 2006:</u></b>				
U.S. Government agencies	\$ 69,746	\$ 51	\$ (1,293)	\$ 68,504
U.S. Government agency collateralized mortgage obligations	17	0	(1)	16

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Obligations of state and political subdivisions	2,226	65	(1)	2,290
Other investment securities	13,000	0	(444)	12,556
	\$ 84,989	\$ 116	\$ (1,739)	\$ 83,366

5

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Included in other investment securities at September 30, 2007, is a short-term government securities mutual fund totaling \$7.6 million, a CRA-qualified mortgage fund totaling \$4.8 million, and a money-market mutual fund totaling \$716,000. Included in other investment securities at December 31, 2006, is a short-term government securities mutual fund totaling \$7.7 million, and a CRA-qualified mortgage fund totaling \$4.8 million. The short-term government securities mutual fund invests in debt securities issued or guaranteed by the U.S. Government, its agencies or instrumentalities, with a maximum duration equal to that of a 3-year U.S. Treasury Note.

There were no realized gains or losses on sales or calls of available-for-sale securities during the nine months ended September 30, 2007 or September 30, 2006.

Securities that have been temporarily impaired less than 12 months at September 30, 2007 are comprised of seven U.S. government agency securities and one municipal agency security, with a total weighted average life of 9.4 years. As of September 30, 2007, there were twelve U.S. government agency securities, one collateralized mortgage obligation, one municipal agency security, and two other investment securities with a total weighted average life of 0.9 years that have been temporarily impaired for twelve months or more.

The following summarizes temporarily impaired investment securities at September 30, 2007:

<i>(In thousands)</i>	Less than 12 Months		12 Months or More		Total	
	Fair Value(Carrying Amount)	Unrealized Losses	Fair Value(Carrying Amount)	Unrealized Losses	Fair Value(Carrying Amount)	Unrealized Losses
<u>Securities available for sale:</u>						
U.S. Government agencies	\$ 23,876	\$ (96)	\$ 43,553	\$ (561)	\$ 67,429	\$ (657)
U.S. Government agency collateralized mortgage obligations	0	0	10	0	10	0
Obligations of state and political subdivisions	84	0	35	0	119	0
Other investment securities	0	0	12,471	(529)	12,471	(529)
Total impaired securities	\$ 23,960	\$ (96)	\$ 56,069	\$ (1,090)	\$ 80,029	\$ (1,186)

Because the decline in market value is attributable to changes in market rates of interest rather than credit quality, and because the Company has the ability and intent to hold these investments until a recovery of fair value, which may be at maturity, the Company considers these investments to be temporarily impaired at September 30, 2007.

At September 30, 2007 and December 31, 2007, available-for-sale securities with an amortized cost of approximately \$70.9 million and \$70.9 million (fair value of \$70.4 million and \$69.7 million) were pledged as collateral for public funds, treasury tax and loan balances, and repurchase agreements.

### 3. *Loans and Leases*

Loans include the following:

<i>(In thousands)</i>	September 30,	% of	December 31,	% of
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	2007	Loans	2006	Loans
Commercial and industrial	\$ 207,123	33.2%	\$ 155,811	31.1%
Real estate – mortgage	150,274	24.0%	113,613	22.7%
Real estate – construction	186,147	29.7%	168,378	33.7%
Agricultural	53,277	8.5%	35,102	7.0%
Installment/other	19,496	3.1%	16,712	3.3%
Lease financing	9,631	1.5%	10,952	2.2%
Total Gross Loans	\$ 625,948	100.0%	\$ 500,568	100.0%

There were no loans over 90 days past due and still accruing interest at September 30, 2007 or December 31, 2006. Nonaccrual loans totaled \$17.1 million and \$8.1 million at September 30, 2007 and December 31, 2006, respectively.

An analysis of changes in the allowance for credit losses is as follows:

<i>(In thousands)</i>	Sept 30, 2007	December 31, 2006	Sept 30, 2006
Balance, beginning of year	\$ 8,365	\$ 7,748	\$ 7,748
Provision charged to operations	2,360	880	639
Losses charged to allowance	(1,916)	(502)	(475)
Recoveries on loans previously charged off	44	239	93
Reserve acquired in merger	1,268	—	—
Balance at end-of-period	\$ 10,121	\$ 8,365	\$ 8,005

The allowance for credit losses represents management's estimate of the risk inherent in the loan portfolio based on the current economic conditions, collateral values and economic prospects of the borrowers. The formula allowance for unfunded loan commitments totaling \$609,000 at September 30, 2007 is carried in other liabilities. Significant changes in these estimates might be required in the event of a downturn in the economy and/or the real estate markets in the San Joaquin Valley, and the greater Oakhurst and East Madera County areas.

The following table summarizes the Company's investment in loans for which impairment has been recognized for the periods presented:

<i>(in thousands)</i>	September 30, 2007	December 31, 2006	September 30, 2006
Total impaired loans at period-end	\$ 23,060	\$ 8,893	\$ 8,839
Impaired loans which have specific allowance	12,920	5,638	5,529
Total specific allowance on impaired loans	5,192	4,117	3,861
Total impaired loans which as a result of write-downs or the fair value of the collateral, did not have a specific allowance	10,140	3,255	3,310
	YTD - 9/30/07	YTD - 12/31/06	YTD - 9/30/06
Average recorded investment in impaired loans during period	\$ 14,745	\$ 10,088	\$ 10,382
Income recognized on impaired loans during period	0	65	35

#### 4.

#### *Deposits*

*Deposits include the following:*



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<i>(In thousands)</i>	September 30, 2007	December 31, 2006
Noninterest-bearing deposits	\$ 152,787	\$ 159,002
Interest-bearing deposits:		
NOW and money market accounts	184,465	184,384
Savings accounts	45,448	31,933
Time deposits:		
Under \$100,000	47,797	42,428
\$100,000 and over	239,031	169,380
Total interest-bearing deposits	516,741	428,125
Total deposits	\$ 669,528	\$ 587,127

7

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## 5. *Short-term Borrowings/Other Borrowings*

At September 30, 2007, the Company had collateralized and uncollateralized lines of credit with the Federal Reserve Bank of San Francisco and other correspondent banks aggregating \$385.4 million, as well as Federal Home Loan Bank (“FHLB”) lines of credit totaling \$22.2 million. At September 30, 2007, the Company had total outstanding balances of \$20.0 million drawn against its FHLB line of credit. Of the \$20.0 million in FHLB borrowings outstanding at September 30, 2007, \$10.0 million was in overnight borrowings, and the other \$10.0 million consists of a two-year FHLB advance, at a fixed rate of 4.92%, and a maturity date of March 30, 2009.

The Company had collateralized and uncollateralized lines of credit with the Federal Reserve Bank of San Francisco and other correspondent banks aggregating \$308.3 million, as well as Federal Home Loan Bank (“FHLB”) lines of credit totaling \$28.0 million at December 31, 2006. At December 31, 2006, the Company had no advances on its lines of credit.

These lines of credit generally have interest rates tied to the Federal Funds rate or are indexed to short-term U.S. Treasury rates or LIBOR. FHLB advances are collateralized by all of the Company’s stock in the FHLB and certain qualifying mortgage loans. All lines of credit are on an “as available” basis and can be revoked by the grantor at any time.

## 6. *Supplemental Cash Flow Disclosures*

<i>(In thousands)</i>	Nine Months Ended Sept 30,	
	2007	2006
Cash paid during the period for:		
Interest	\$ 15,393	\$ 10,102
Income Taxes	5,556	5,990
Noncash investing activities:		
Dividends declared not paid	\$ 1,490	1,245
Supplemental disclosures related to acquisitions:		
Deposits	\$ 69,600	
Other liabilities	286	
Securities available for sale	(7,414)	
Loans, net of allowance for loan losses	(62,426)	
Premises and equipment	(728)	
Intangibles	(11,085)	
Accrued interest and other assets	(3,396)	
Stock issued	21,536	
Net cash and equivalents acquired	\$ 6,373	

## 7. *Net Income per Common Share*

The following table provides a reconciliation of the numerator and the denominator of the basic EPS computation with the numerator and the denominator of the diluted EPS computation:

<i>(In thousands except earnings per share data)</i>	Quarter Ended Sept 30,		Nine Months Ended Sept 30,	
	2007	2006	2007	2006

Net income available to common shareholders	\$	3,657	\$	3,461	\$	10,568	\$	10,387
Weighted average shares issued		11,931		11,338		11,939		11,358
Add: dilutive effect of stock options		21		117		44		118
Weighted average shares outstanding adjusted for potential dilution		11,952		11,455		11,983		11,476
Basic earnings per share	\$	0.31	\$	0.31	\$	0.89	\$	0.91
Diluted earnings per share	\$	0.31	\$	0.30	\$	0.88	\$	0.91

8. *Derivative Financial Instruments and Hedging Activities*

As part of its overall risk management, the Company pursues various asset and liability management strategies, which may include obtaining derivative financial instruments to mitigate the impact of interest fluctuations on the Company's net interest margin. During the second quarter of 2003, the Company entered into an interest rate swap agreement for the purpose of minimizing interest rate fluctuations on its interest rate margin and equity.

Under the interest rate swap agreement, the Company receives a fixed rate and pays a variable rate based on the Prime Rate ("Prime"). The swap qualifies as a cash flow hedge under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended, and is designated as a hedge of the variability of cash flows the Company receives from certain variable-rate loans indexed to Prime. In accordance with SFAS No. 133, the swap agreement is measured at fair value and reported as an asset or liability on the consolidated balance sheet. The portion of the change in the fair value of the swap that is deemed effective in hedging the cash flows of the designated assets is recorded in accumulated other comprehensive income and reclassified into interest income when such cash flow occurs in the future. Any ineffectiveness resulting from the hedge is recorded as a gain or loss in the consolidated statement of income as part of noninterest income.

The amortizing hedge has a remaining notional value of \$5.8 million at September 30, 2007, matures in September 2008, and has a duration of approximately 3 months. As of September 30, 2007, the maximum length of time over which the Company is hedging its exposure to the variability of future cash flows is approximately 1.25 years. As of September 30, 2007, the loss amounts in accumulated other comprehensive income associated with these cash flows totaled \$15,000 (net of tax benefit of \$10,000). During the nine months ended September 30, 2007, \$270,000 was reclassified from other accumulated comprehensive income into expense, and is reflected as a reduction in interest income.

The Company performed a quarterly analysis of the effectiveness of the interest rate swap agreement at September 30, 2007. As a result of a correlation analysis, the Company has determined that the swap remains highly effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedge and, therefore, continues to qualify for hedge accounting under the guidelines of SFAS No. 133. However, during the second quarter of 2006, the Company determined that the underlying loans being hedged were paying off faster than the notional value of the hedge instrument was amortizing. This difference between the notional value of the hedge and the underlying hedged assets is considered an "overhedge" pursuant to SFAS No. 133 guidelines and may constitute ineffectiveness if the difference is other than temporary. The Company determined during 2006 that the difference was other than temporary and, as a result, reclassified a net total of \$75,000 of the pretax hedge loss reported in other comprehensive income into earnings during 2006. As of September 30, 2007, the notional value of the hedge was still in excess of the value of the underlying loans being hedged by approximately \$3.2 million, but had improved from the \$3.3 million difference existing at December 31, 2006. As a result, the Company recorded a pretax hedge gain related to swap ineffectiveness of approximately \$44,000 during the first nine months of 2007. Amounts recognized as hedge ineffectiveness gains or losses are reflected in noninterest income.

## **9. *Common Stock Repurchase Plan***

During August 2001, the Company's Board of Directors approved a plan to repurchase, as conditions warrant, up to 280,000 shares (effectively 580,000 shares adjusted for 2-for-1 stock split in May 2006) of the Company's common stock on the open market or in privately negotiated transactions. The duration of the program is open-ended and the timing of the purchases will depend on market conditions.

On February 25, 2004, the Company announced another stock repurchase plan under which the Board of Directors approved a plan to repurchase, as conditions warrant, up to 276,500 shares (effectively 553,000 shares adjusted for 2-for-1 stock split in May 2006) of the Company's common stock on the open market or in privately negotiated transactions. As with the first plan, the duration of the new program is open-ended and the timing of purchases will depend on market conditions. Concurrent with the approval of the new repurchase plan, the Board terminated the 2001 repurchase plan. During the year ended December 31, 2005, 13,081 shares (26,162 shares effected for 2006 2-for-1 stock split) were repurchased at a total cost of \$377,000 and an average price per share of \$28.92 (\$14.46 effected for 2006 2-for-1 stock split). During the year ended December 31, 2006, 108,005 shares were repurchased at a total cost of \$2.4 million and an average price per share of \$22.55.

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

During the nine months ended September 30, 2007, 453,077 shares were repurchased at a total cost of \$9.2 million and an average per share price of \$20.20. Of the shares repurchased during 2007, 166,660 shares were repurchased under the 2004 plan at an average cost of \$20.46 per shares, and 286,417 shares were repurchased under the 2007 plan at an average cost of \$20.05 per shares.

#### 10. *Stock Based Compensation*

On January 1, 2006 the Company adopted the disclosure provisions of Financial Accounting Standards Board (FASB) Statement No. 123 R, "Accounting for Share-Based Payments". SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on the grant-date fair value of the award. The fair value is amortized over the requisite service period (generally the vesting period).

Included in salaries and employee benefits for the nine months ending September 30, 2007 and 2006 is \$140,000 and \$175,000 of share-based compensation, respectively. The related tax benefit on share-based compensation recorded in the provision for income taxes was not material to either quarter.

A summary of the Company's options as of January 1, 2007 and changes during the nine months ended September 30, 2007 is presented below.

	2005 Plan	Weighted Average Exercise Price	1995 Plan	Weighted Average Exercise Price
Options outstanding January 1, 2007	171,500	\$ 17.05	126,000	\$ 7.25
Granted during the period	5,000	20.24	—	—
Exercised during the period	0	—	(90,000)	5.67
Options outstanding Sept 30, 2007	176,500	\$ 17.14	36,000	\$ 11.21
Options exercisable at Sept 30, 2007	46,700	\$ 16.34	24,000	\$ 10.74

As of September 30, 2007 and 2006, there was \$270,000 and \$461,000, respectively, of total unrecognized compensation expense related to nonvested stock options. This cost is expected to be recognized over a weighted average period of approximately 1.25 years and 1.75 years, respectively. The Company received \$510,000 and \$310,000 in cash proceeds on options exercised during the nine months ended September 30, 2007 and 2006, respectively. No tax benefits were realized on stock options exercised during the nine months ended September 30, 2007, because all options exercised during the period were incentive stock options. Tax benefits realized on options exercised during the nine months ended September 30, 2006 totaled \$201,000.

	Period Ended Sept 30, 2007	Period Ended Sept 30, 2006
Weighted average grant-date fair value of stock options granted	\$ 4.51	\$ 4.30
Total fair value of stock options vested	\$ 167,028	\$ 61,030
Total intrinsic value of stock options exercised	\$ 1,517,000	\$ 631,320

The Company determines fair value at grant date using the Black-Scholes-Merton pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option, the volatility of the underlying stock and the expected dividend yield and the risk-free interest rate over the expected life of the option.

The weighted average assumptions used in the pricing model are noted in the table below. The expected term of options granted is derived using the simplified method, which is based upon the average period between vesting term and expiration term of the options. The risk free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. Expected volatility is based on the historical volatility of the Bank's stock over a period commensurate with the expected term of the options. The Company believes that historical volatility is indicative of expectations about its future volatility over the expected term of the options.

For options vested as of January 1, 2006 or granted after January 1, 2006, and valued in accordance with FAS 123R, the Company expenses the fair value of the option on a straight-line basis over the vesting period for each separately vesting portion of the award. The Company estimates forfeitures and only recognizes expense for those shares expected to vest. Based upon historical evidence, the Company has determined that because options are granted to a limited number of key employees rather than a broad segment of the employee base, expected forfeitures, if any, are not material.

	Six Months Ended	
	September 30, 2007	September 30, 2006
Risk Free Interest Rate	4.53%	4.65%
Expected Dividend Yield	2.47%	2.38%
Expected Life in Years	6.50 Years	6.50 Years
Expected Price Volatility	20.63%	20.35%

The Black-Scholes-Merton option valuation model requires the input of highly subjective assumptions, including the expected life of the stock based award and stock price volatility. The assumptions listed about represent management's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, the Company's recorded stock-based compensation expense could have been materially different from that previously reported by the Company. In addition, the Company is required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If the Company's actual forfeiture rate is materially different from the estimate, the share-based compensation expense could be materially different.

## II. *Taxes – Adoption of FIN48*

The Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN48), on January 1, 2007. FIN 48 clarifies SFAS No. 109, "Accounting for Income Taxes", to indicate a criterion that an individual tax position would have to meet for some or all of the income tax benefit to be recognized in a taxable entity's financial statements. Under the guidelines of FIN48, an entity should recognize the financial statement benefit of a tax position if it determines that it is *more likely than not* that the position will be sustained on examination. The term, "more likely than not", means a likelihood of more than 50 percent." In assessing whether the more-likely-than-not criterion is met, the entity should assume that the tax position will be reviewed by the applicable taxing authority and all available information is known to the taxing authority.

The Company and a subsidiary file income tax returns in the U.S federal jurisdiction, and several states within the U.S. There are no filings in foreign jurisdictions. The Company is not currently aware of any tax jurisdictions where the Company or any subsidiary is subject examination by federal, state, or local taxing authorities before 2001. The Internal Revenue Service (IRS) has not examined the Company's or any subsidiaries federal tax returns since before 2001, and the Company currently is not aware of any examination planned or contemplated by the IRS. The California Franchise Tax Board (FTB) is currently examining the Company's 2004 state tax return, and it is anticipated that the examination will be completed during the fourth quarter of 2007. There were no contingencies included in the financial statements at September 30, 2007 for the FTB's examination of the Company's 2004 tax state tax return.

During the second quarter of 2006, the FTB issued the Company a letter of proposed adjustments to, and assessments for, (as a result of examination of the tax years 2001 and 2002) certain tax benefits taken by the REIT during 2002. The Company continues to review the information available from the FTB and its financial advisors and believes that the Company's position has merit. The Company is pursuing its tax claims and will defend its use of these entities and transactions. The Company will continue to assert its administrative protest and appeal rights pending the outcome of litigation by another taxpayer presently in process on the REIT issue in the Los Angeles Superior Court (City National v. Franchise Tax Board).





The Company has reviewed its REIT tax position as of January 1, 2007 (adoption date) and again at March 31, 2007, June 30, 2007, and September 30, 2007 in light of the adoption of FIN48. The Bank, with guidance from advisors believes that the case has merit with regard to points of law, and that the tax law at the time allowed for the deduction of the consent dividend. However, the Bank, with the concurrence of advisors, cannot conclude that it is “more than likely” (as defined in FIN48) that the Bank will prevail in its case with the FTB. As a result of the implementation of FIN48, the Company recognized approximately a \$1.3 million increase in the liability for unrecognized tax benefits (included in other liabilities), which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. The adjustment provided at adoption included penalties proposed by the FTB of \$181,000 and interest totaling \$210,000. During the nine months ended September 30, 2007, the Company recorded an additional \$43,000 in interest liability pursuant to the provisions of FIN48. The Company had approximately \$434,000 accrued for the payment of interest and penalties at September 30, 2007. Subsequent to the initial adoption of FIN48, it is the Company’s policy to recognize interest expense related to unrecognized tax benefits, and penalties, as a component tax expense. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in 000’s):

Balance at January 1, 2007	\$ 1,298
Additions for tax provisions of prior years	43
Balance at September 30, 2007	\$ 1,341

## 12. *Fair Value – Adoption of SFAS No. 159*

Effective January 1, 2007, the Company elected early adoption of SFAS No.159, “The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115”. The Company also adopted the provisions of SFAS No. 157, “Fair Value Measurements”, effective January 1, 2007, in conjunction with the adoption of SFAS No. 159. SFAS No. 159 generally permits the measurement of selected eligible financial instruments at fair value at specified election dates. Upon adoption of SFAS No. 159, the Company elected the fair value measurement option for all the Company’s pre-existing junior subordinated debentures with a carrying cost of \$15.5 million, prior to the adoption of SFAS No. 159.

The Company believes its adoption of SFAS No. 159 will have a positive impact on its ability to better manage the balance sheet and interest rate risks associated with this liability while potentially benefiting the net interest margin, net interest income, net income and earnings per common share in future periods. Specifically, the Company believes the election of fair value accounting for the junior subordinated debentures better reflects the true economic value of the debt instrument on the balance sheet. The Company’s junior subordinated debentures were issued in 2001 when the Trust Preferred Securities market was new and less liquid than today. As a result, subordinated debentures are available in the market at narrower spreads and lower issuing costs. With a higher-than-market spread to LIBOR, and remaining capitalized issuance costs of more than \$400,000 on the balance sheet, the Company’s cost-basis of the subordinated debentures recorded on the balance sheet does not properly reflect the true opportunity costs to the Company.

The initial fair value measurement at adoption resulted in a \$1,053,000 cumulative-effect adjustment to the opening balance of retained earnings at January 1, 2007. The adjustment resulted in an increase of \$1,053,000 in the reported balance of the junior subordinated debentures, an increase in deferred tax assets of \$443,000 and the corresponding reduction in retained earnings of \$610,000. Under SFAS No. 159, this one-time charge to shareholders’ equity was not recognized in earnings. In addition to the fair value adjustment of the junior subordinated debentures recorded effective January 1, 2007, the Company also removed the remaining \$405,000 in unamortized issuance costs of the debt instrument. The remaining issuance costs were removed in accordance with SFAS 159 effective January 1, 2007, with corresponding charges of \$170,000 to deferred taxes and \$235,000 to retained earnings.

As a requirement of electing early adoption of SFAS 159, the Company also adopted SFAS 157, “Fair Value Measurement” effective January 1, 2007. The Company utilized the guidelines of SFAS No. 157 to perform the fair

value analysis on the junior subordinated debentures. In its analysis, the Company used a net-present-value approach based upon observable market rates of interest, over a term that considers the most advantageous market for the liability, and the most reasonable behavior of market participants.

The following table summarizes the effects of the adoption of SFAS No. 159 at both adoption date and September 30, 2007 (in 000's) on the Company's junior subordinated debentures. Changes in fair value (FV) for periods subsequent to adoption are recorded in current earnings. Pretax changes in fair value for the nine months ended September 30, 2007 totaled \$2.2 million and are included as a gain in other noninterest income.

Balance of junior subordinated debentures at December 31, 2006	\$	15,464
Adjustments upon adoption:		
Combine accrued interest 1/1/07		613
Total carrying value 1/1/07		16,077
FV adjustment upon adoption of SFAS No. 159		1,053
Total FV of junior subordinated debentures at adoption - January 1, 2007	\$	17,130
Total FV of junior subordinated debentures at September 30, 2007	\$	13,554

### 13. *Redemption of Trust Preferred Securities and formation of USB Capital Trust II*

At June 30, 2007, the Company held junior subordinated debentures issued to capital trusts commonly known as "Trust Preferred securities." The debt instrument was issued by the Company's wholly-owned special purpose trust entity, USB Capital Trust I on July 25, 2001 in the amount of \$15,000,000 with a thirty-year maturity, interest benchmarked at the 6-month-LIBOR rate (re-priced in January and July each year) plus 3.75%. The Company had the ability to redeem the debentures at its option. The prepayment provisions of the instrument allowed repayment after five years (July 25, 2006) with certain prepayment penalties. On July 25, 2007, the Company redeemed the \$15.0 million in subordinated debentures plus accrued interest of \$690,000 and a 6.15% prepayment penalty totaling \$922,500. Concurrently, the Trust Preferred securities issued by Capital Trust I were redeemed. The prepayment penalty of \$922,500 had previously been a component of the fair value adjustment for the junior subordinated debt at the initial adoption of SFAS No. 159, and as a result was recorded through retained earnings effective January 1, 2007.

During July 2007, the Company formed USB Capital Trust II, a wholly-owned special purpose entity, for the purpose of issuing Trust Preferred Securities. Like USB Capital Trust I formed in July 2001, USB Capital Trust II is a Variable Interest Entity (VIE) and will be considered a deconsolidated entity pursuant to FIN 46. On July 23, 2007 USB Capital Trust II issued \$15 million in Trust Preferred securities. The securities have a thirty-year maturity and bear a floating rate of interest (repricing quarterly) of 1.29% over the three-month LIBOR rate (initial coupon rate of 6.65%). Interest will be paid quarterly. Concurrent with the issuance of the Trust Preferred securities, USB Capital Trust II used the proceeds of the Trust Preferred securities offering to purchase a like amount of junior subordinated debentures of the Company. The Company will pay interest on the junior subordinated debentures to USB Capital Trust II, which represents the sole source of dividend distributions to the holders of the Trust Preferred securities. The Company may redeem the junior subordinated debentures at anytime before October 2008 at a redemption price of 103.3, and thereafter each October as follows: 2008 at 102.64, 2009 at 101.98, 2010 at 101.32, 2011 at 100.66, and at par anytime after October 2012.

As with the previous junior subordinated securities issued under USB Capital Trust I, the Company has elected the fair value measurement option for all the Company's new junior subordinated debentures issued under USB Capital Trust II. During the quarter ended September 30, 2007, the Company recorded a pre-tax gain of \$2.1 million pursuant to SFAS No. 159 as measured under fair value measurement guidelines of SFAS No. 157. The gain realized during the third quarter resulted from an overall deterioration of the credit markets during the third quarter of 2007 which increased pricing spreads from base rates on similar debt instruments.

### 14. *Fair Value Measurements—Adoption of SFAS No. 157*

Effective January 1, 2007, the Company adopted SFAS 157, "Fair Value Measurements", concurrent with its early adoption of SFAS No. 159. SFAS No. 157 clarifies the definition of fair value, describes methods used to appropriately measure fair value in accordance with generally accepted accounting principles and expands fair value disclosure requirements. This statement applies whenever other accounting pronouncements require or permit fair

value measurements.

The fair value hierarchy under SFAS No. 157 prioritizes the inputs to valuation techniques used to measure fair value into three broad levels (Level 1, Level 2, and Level 3). Level 1 inputs are unadjusted quoted prices in active markets (as defined) for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability, and reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk).

13

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The Company performs fair value measurements on certain assets and liabilities as the result of the application of accounting guidelines and pronouncements that were relevant prior to the adoption of SFAS No. 157. Some fair value measurements, such as for available-for-sale securities and interest rate swaps are performed on a recurring basis, while others, such as impairment of goodwill and other intangibles, are performed on a nonrecurring basis.

The following tables summarize the Company's assets and liabilities that were measured at fair value on a recurring basis during the period (in 000's):

Description of Assets	September 30, 2007	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
		(Level 1)	(Level 2)	(Level 3)
AFS Securities	\$ 88,657	\$ 88,657		
Interest Rate Swap	(56)		(\$56)	
Impaired Loans	16,693		15,264	\$ 1,429
Total	\$ 105,294	\$ 88,657	\$ 15,208	\$ 1,429

Description of Liabilities	September 30, 2007	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
		(Level 1)	(Level 2)	(Level 3)
Junior subordinated debt	\$ 13,554		\$ 13,554	
Total	\$ 13,554	\$ 0	\$ 13,554	\$ 0

Available for sale securities are valued based upon open-market quotes obtained from reputable third-party brokers. Market pricing is based upon specific CUSIP identification for each individual security. Changes in fair market value are recorded in other comprehensive income as the securities are available for sale.

The fair value of interest rate swap contracts is based on the discounted net present value of the swap using third party dealer quotes. Changes in fair market value are recorded in other comprehensive income, and changes resulting from ineffectiveness are recorded in current earnings.

Fair value measurements for impaired loans are performed pursuant to SFAS No. 114, and are based upon either collateral values supported by appraisals, or observed market prices. The change in fair value of impaired assets that were valued based upon level three inputs was approximately \$92,000 for the nine months ended September 30, 2007. This loss is not recorded directly as an adjustment to current earnings or comprehensive income, but rather as an adjustment component in determining the overall adequacy of the loan loss reserve. Such adjustments to the estimated fair value of impaired loans may result in increases or decreases to the provision for credit losses recorded in current earnings.

Upon adoption of SFAS No. 159 on January 1, 2007, the Company elected the fair value measurement option for all the Company's pre-existing junior subordinated debentures, and subsequently for new junior subordinated debentures issued during July 2007 under USB Capital Trust II. The fair value of the debentures was determined based upon

discounted cash flows utilizing observable market rates and credit characteristics for similar instruments. In its analysis, the Company used characteristics that distinguish market participants generally use, and considered factors specific to (a) the liability, (b) the principal (or most advantageous) market for the liability, and (c) market participants with whom the reporting entity would transact in that market. The adjustment for fair value at adoption was recorded as a cumulative-effect adjustment to the opening balance of retained earnings at January 1, 2007. Fair value adjustments subsequent to adoption are recorded in current earnings (see Notes 12 and 13 to the financial statements included herein in the Company's 10-Q for September 30, 2007).

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The following tables summarize the Company's assets and liabilities that were measured at fair value on a nonrecurring basis during the period (in 000's):

Description of Assets	(in 000's) Sept 30, 2007	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Business combination:</b>				
Securities – AFS	\$ 7,414	\$ 7,414		
Loans, net allowance for losses	62,426			\$ 62,426
Premises and Equipment	729			729
Goodwill	8,085			8,085
Other assets	7,633			7,633
<b>Total assets</b>	<b>\$ 86,287</b>	<b>\$ 7,414</b>	<b>\$ 0</b>	<b>\$ 78,873</b>

Description of Liabilities	(in 000's) Sept 30, 2007	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Business combination:</b>				
Deposits (net CDI)	\$ 66,600			\$ 66,600
Other liabilities	286			286
<b>Total liabilities</b>	<b>\$ 66,886</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 66,886</b>

The Company completed its merger with Legacy Bank in February 2007 (see Note 15 to the financial statements included herein in the Company's 10-Q for September 30, 2007). The merger transaction was accounted for using the purchase accounting method, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Legacy Bank based on the fair value of those assets and liabilities. The allocations of purchase price based upon the fair market value of assets acquired and liabilities assumed is preliminary, but management does not believe that adjustments, if any, will be material. The fair value measurements for Legacy's loan portfolio included certain market rate assumptions on segmented portions of the loan portfolio with similar credit characteristics, and credit risk assumptions specific to the individual loans within that portfolio. Available-for sale securities were valued based upon open-market quotes obtained from reputable third-party brokers. Legacy's deposits were valued based upon anticipated net present cash flows related to Legacy's deposit base, and resulted in a core deposit intangible (CDI) adjustment of \$3.0 million carried as an asset on the Company's balance sheet. Assumptions used to determine the CDI included anticipated costs of, and revenues generated by, those deposits, as well as the estimated life of the deposit base. Other assets and liabilities generally consist of short-term items including cash, overnight investments, and accrued interest receivable or payable, and as such, it was determined that carrying value approximated fair value.

The following tables provide a reconciliation of assets and liabilities at fair value using significant unobservable inputs (Level 3) on both a recurring (impaired loans) and nonrecurring (business combination) basis during the period (in 000's):

	Impaired Loans
<b>Reconciliation of Assets:</b>	
Beginning balance	\$ 1,521
	(203)



Total gains or (losses) included in earnings (or changes in net assets)	
Transfers in and/or out of Level 3	111
Ending balance	\$ 1,429

The amount of total gains or (losses) for the period included in earnings (or changes in net assets) attributable to the change in unrealized gains or losses relating to assets still held at the reporting date	(\$203)
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15.

**Business Combination**

On February 16, 2007, the Company acquired 100 percent of the outstanding common shares of Legacy Bank, N.A., located in Campbell, California. At merger, Legacy Bank's one branch was merged with and into United Security Bank, a wholly owned subsidiary of the Company. The purchase of Legacy Bank provided the Company with an opportunity to expand its market area into Santa Clara County and to serve a loyal and growing small business niche and individual client base build by Legacy.

The aggregate purchase price for Legacy was \$21.7 million, which included \$171,000 in direct acquisition costs related to the merger. At the date of merger, Legacy Bank had 1,674,373 shares of common stock outstanding. Based upon an exchange rate of approximately .58 shares of the Company's stock for each share of Legacy stock, Legacy shareholders received 976,411 shares of the Company's common stock, amounting to consideration of approximately \$12.86 per Legacy common share.

Legacy's results of the operations have been included in the Company's results beginning February 17, 2007.

During the second quarter of 2007, the Company re-evaluated the preliminary estimate of the core deposit intangible related to savings accounts acquired from Legacy and determined that the initial run-off of those deposits was faster than originally anticipated. As a result, the Company reduced the core deposits intangible by approximately \$215,000 from the amount reported at March 31, 2007. Correspondingly, resultant goodwill was increased by that same \$215,000.

The following summarizes the purchase and the resultant allocation to fair-market-value adjustments and goodwill:

<b>Purchase Price:</b>	
Total value of the Company's common stock exchanged	\$ 21,536
Direct acquisition costs	177
Total purchase price	21,713
<b>Allocation of Purchase Price:</b>	
Legacy's shareholder equity	8,588
Estimated adjustments to reflect assets acquired and liabilities assumed at fair value:	
Investments	23
Loans	(118)
Deferred tax asset (NOL)	2,135
Core Deposit Intangible	3,000
Estimated fair value of net assets acquired	13,628
Goodwill resulting from acquisition	\$ 8,085

The following condensed balance sheet summarizes the amount assigned for each major asset and liability category of Legacy at the merger date:

<b>Assets:</b>		
Cash	\$	3,173
Federal Funds Purchased		3,200
Securities available for sale		7,414
Loans, net of allowance for loan losses		62,426
Premises and equipment		729
Deferred tax assets (NOL)		2,135
Core deposit intangibles		3,000
Goodwill		8,085
Accrued interest and other assets		1,260
<b>Total Assets</b>	<b>\$</b>	<b>91,422</b>
<b>Liabilities:</b>		
<b>Deposits:</b>		
Non-interest bearing	\$	17,262
Interest-bearing		52,338
<b>Total deposits</b>	<b>\$</b>	<b>69,600</b>
Accrued interest payable and other liabilities		286
<b>Total liabilities</b>	<b>\$</b>	<b>69,886</b>
<b>Net assets</b>	<b>\$</b>	<b>21,536</b>

The merger transaction was accounted for using the purchase accounting method, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Legacy Bank based on the fair value of those assets and liabilities. The allocations of purchase price based upon the fair market value of assets acquired and liabilities assumed are preliminary, but management does not believe that adjustments, if any, will be material. While management believes the Company will be able to fully utilize the net operating loss carry-forward (NOL) obtained in the Legacy merger, the 2007 portion of Legacy's NOL has not been finalized, which may result in minor adjustments to the deferred tax asset carried on the Company's balance sheet. The Company has utilized a fair value approach for Legacy's loan portfolio which includes certain market rate assumptions on segmented portions of the loan portfolio with similar credit characteristics, and credit risk assumptions specific to the individual loans within that portfolio. Additional changes, if any, in the fair-market-value assumptions used for purchase allocation purposes will be reflected as an adjustment to goodwill.

Core deposit intangibles totaling \$3.0 million will be amortized for book purposes over an estimated life of approximately 7 years using the yield method. Core deposit intangibles will be reviewed for impairment on an annual basis.

Goodwill totaling \$8.1 million will not be amortized for book purposes under current accounting guidelines. Because the merger was a tax-deferred stock-for-stock purchase, goodwill is not deductible for tax purposes. Goodwill will be reviewed for impairment on an annual basis.

#### **16. Employee Benefit Plans – Application of SFAS No. 158**

In the Company's Form 10-K for the year ended December 31, 2006, a transition adjustment in the amount of \$169,000 net of tax benefit of \$112,000, was recognized as a component of the ending balance of Accumulated Other Comprehensive Income/(Loss) on the Company's balance sheet as the result of the adoption of SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans".

This adjustment was misapplied as a component of Comprehensive Income on the Company's consolidated statement of income and comprehensive income for the year ended December 31, 2006. The table below reflects the effects of the misapplication of this adjustment at December 31, 2006.

<i>(in 000's)</i>	As Reported	Misapplied	As Revised
Other comprehensive loss, net of tax	\$ 462	\$ (169)	\$ 631
Comprehensive income	\$ 13,822	\$ (169)	\$ 13,991

The Company will correct the Other Comprehensive Income presentations in the Form 10-K for the fiscal year ending December 31, 2007 to reflect the revised amounts shown above.

17.

***Subsequent events – Other Real Estate Owned***

Other real estate owned (“OREO”), consisting of real estate acquired through foreclosure of collateral that secured loans, totaled \$2.5 million at September 30, 2007. Subsequent to quarter-end, one OREO property carried at a value of \$563,000 at September 30, 2007 was sold resulting in a pretax loss of \$6,000. During October 2007, two nonaccrual loans totaling \$ 6.3 million at September 30, 2007 were transferred to OREO. Accrued interest of approximately \$866,000 on one nonaccrual loan with principal of \$6.0 million was included in the transfer to OREO as an adjustment to the carrying value of the property. OREO was \$9.1 million at October 31, 2007 after the transfers.

18

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**Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations****Overview**

*Certain matters discussed or incorporated by reference in this Quarterly Report of Form 10-Q are forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Such risks and uncertainties include, but are not limited to, those described in Management's Discussion and Analysis of Financial Condition and Results of Operations. Such risks and uncertainties include, but are not limited to, the following factors: i) competitive pressures in the banking industry and changes in the regulatory environment; ii) exposure to changes in the interest rate environment and the resulting impact on the Company's interest rate sensitive assets and liabilities; iii) decline in the health of the economy nationally or regionally which could reduce the demand for loans or reduce the value of real estate collateral securing most of the Company's loans; iv) credit quality deterioration that could cause an increase in the provision for loan losses; v) Asset/Liability matching risks and liquidity risks; volatility and devaluation in the securities markets, and vi) expected cost savings from recent acquisitions are not realized. Therefore, the information set forth therein should be carefully considered when evaluating the business prospects of the Company. For additional information concerning risks and uncertainties related to the Company and its operations, please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2006.*

On February 16, 2007, the Company completed its merger of Legacy Bank, N.A. with and into United Security Bank, a wholly owned subsidiary of the Company. Legacy Bank which began operations in 2003 operated one banking office in Campbell, California serving small business and retail banking clients. With its small business and retail banking focus, Legacy Bank provides a unique opportunity for United Security Bank to serve a loyal and growing small business niche and individual client base in the San Jose area. Upon completion of the merger, Legacy Bank's branch office began operating as a branch office of United Security Bank. As of February 16, 2007 Legacy Bank had net assets of approximately of \$8.6 million, including net loans of approximately \$63 million and deposits of approximately \$70 million.

In the merger, the Company issued 976,411 shares of its stock in a tax free exchange for all of the Legacy Bank common shares. The total value of the transaction was approximately \$21.7 million. The merger transaction was accounted for using the purchase accounting method, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Legacy based on the fair value of those assets and liabilities. Fair-market-value adjustments and intangible assets totaled approximately \$12.9 million, including \$8.1 million in goodwill. The allocations of purchase price based upon the fair market value of assets acquired and liabilities assumed is preliminary, but management does not believe that adjustments, if any, will be material.

The Company currently has eleven banking branches, which provide financial services in Fresno, Madera, Kern, and Santa Clara counties.

***Trends Affecting Results of Operations and Financial Position***

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

	YTD Average 9/30/07	YTD Average 12/31/06	YTD Average 9/30/06
Loans and Leases	84.45%	80.26%	79.61%
	13.74%	15.65%	16.05%

Investment securities available for  
sale

Interest-bearing deposits in other banks	1.15%	1.33%	1.34%
Federal funds sold	0.66%	2.76%	3.00%
Total earning assets	100.00%	100.00%	100.00%
NOW accounts	9.01%	11.21%	11.54%
Money market accounts	27.08%	31.56%	31.28%
Savings accounts	9.14%	8.02%	8.18%
Time deposits	48.44%	44.72%	44.15%
Other borrowings	3.19%	0.96%	1.28%
Subordinated debentures	3.14%	3.53%	3.57%
Total interest-bearing liabilities	100.00%	100.00%	100.00%

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

The Company continues its business development and expansion efforts throughout a dynamic and growing market area, and as a result, realized substantial increases in both loan and deposit volumes during the nine months ended September 30, 2007. With approximately half of the increase resulting from the Legacy Bank merger completed during February 2007, the Company experienced increases of \$125.4 million in loans, while other interest earning assets, including federal funds sold and interest-bearing deposits in other banks, declined during the period, as loan growth exceeded deposit growth during the period. The Company experienced growth in all loan categories except lease financing, with growth being strongest in commercial and industrial loans, and commercial real estate loans. Deposit growth totaled \$82.4 million during the nine months ended September 30, 2007, and deposit increases were to a large degree the result of the merger with Legacy Bank. Deposit growth occurred in all categories except noninterest-bearing deposits, which actually declined \$6.2 million during the nine months ended September 30, 2007. Depositors continue to be attracted to money market accounts and time deposits over \$100,000, as they seek higher yields.

With market rates of interest remaining level through much of 2007, then declining 50 basis points during mid-September 2007, the Company has begun to experience declines in its net interest margin. The Company's net interest margin was 5.50% for the nine months ended September 30, 2007, as compared to 5.67% for the year ended December 31, 2006, and 5.66% for the nine months ended September 30, 2006. With approximately 63% of the loan portfolio in floating rate instruments at September 30, 2007, the effects of market rates continue to be realized almost immediately on loan yields. Loans yielded 9.28% during the nine months ended September 30, 2007, as compared to 9.13% for the year ended December 31, 2006, and 9.06% for the nine months ended September 30, 2006. Loan yield was enhanced during the first nine months of 2007, as a nonperforming loan was paid off during the quarter, providing an additional \$902,000 in previously unrecognized interest income that would not have otherwise been recognized during the nine months ended September 30, 2007, and an enhancement to loan yield of approximately 21 basis points. The Company continues to experience pricing pressures on deposits, especially money market accounts and time deposits, as increased competition for deposits continues throughout the Company's market area. The Company's average cost of funds was 3.90% for the nine months ended September 30, 2007 as compared to 3.24% for the year ended December 31, 2006, and 3.10% for the nine months ended September 30, 2006.

Noninterest income continues to be driven by customer service fees, which totaled \$3.5 million for the nine months ended September 30, 2007, representing an increase of \$598,000 or 20.59% over the \$2.9 million in customer service fees reported for the nine months ended September 30, 2006. Total noninterest income increased by \$422 between the nine-month periods ended September 30, 2006 and September 30, 2007, primarily as the result of a \$2.2 million gain recognized during the nine months ended September 30, 2007 resulting from SFAS No. 159 fair value adjustments to the Company's junior subordinated debt. Offsetting this were several reductions in noninterest income including, a nonrecurring \$1.9 million gain on the sale of an investment in correspondent bank stock recognized during the first quarter of 2006, and a \$1 million gain on the sale of the Company's administrative headquarters during the third quarter of 2006, both of which did not occur again during 2007. Other noninterest income increased approximately \$245,000 as the result of a number of items including increases in rental and OREO income experienced during the first nine months of 2007.

Noninterest expense increased approximately \$1.4 million or 9.3% between the nine-month periods ended September 30, 2006 and September 30, 2007. Increases were experienced in salaries and employee benefits, occupancy expense, professional fees, and other general business expenses, as the Company continues to grow and seek qualified staff as part of its strategic plan. As part of noninterest expense, OREO expense actually declined by \$1.7 million or 93.5%



between the nine-month periods ended September 30, 2006 and September 30, 2007 as costs associated with an OREO property the Company was in the process of liquidating during 2006, were not again incurred during 2007.

The Company has maintained a strong balance sheet, with sustained loan growth and sound deposit growth. With the Legacy merger completed during February 2007, total assets have grown more than \$124.7 million between December 31, 2006 and September 30, 2007, while net loans have grown \$122.8 million, and deposits have grown \$82.4 million during the nine months ended September 30, 2007. With increased loan growth, average loans comprised approximately 84% of overall average earning assets during the nine months ended September 30, 2007. In total, average core deposits, including NOW accounts, money market accounts, and savings accounts, continue to comprise a high percentage of total interest-bearing liabilities for the nine months ended September 30, 2007, although time deposits as a percentage of average deposits for the period have increased during 2007 as the Company has sought brokered deposits to fund continued loan demand. To further fund loan demand, the Company utilized its FHLB credit line during the first quarter of 2007, borrowing \$10.0 million for a term of two years at a fixed rate of 4.92%.

During July 2007, the Company formed USB Capital Trust II, a wholly-owned special purpose entity, for the purpose of issuing Trust Preferred securities. At the same time, the Company redeemed the \$15 million in junior subordinated debt issued to USB Capital Trust I which in turn had issued Trust Preferred securities to investors. The Trust Preferred securities issued by USB Capital Trust I during 2001 carried a floating interest rate of six-month LIBOR plus 3.75% and had a maturity term of thirty years. During July, USB Capital Trust II issued \$15 million in Trust Preferred securities at a floating rate of three-month LIBOR plus 1.29% and had a maturity term of thirty years. Concurrent with the issuance of the Trust Preferred securities, USB Capital Trust II used the proceeds of the Trust Preferred securities offering to purchase a like amount of junior subordinated debentures of the Company with substantially like terms to the Trust Preferred securities issued by the Trust. The new subordinated debentures will reduce the cost of the Company's \$15 million debt by 246 basis points, and should result in pre-tax interest cost savings of approximately \$30,000 per month. Effective January 1, 2007, the Company had elected the fair value option for the Company's junior subordinated debt pursuant to SFAS No. 159. The Company also elected the fair value option for the subordinated debentures issued to USB Capital Trust II during July 2007. As a result of fair value adjustments at September 30, 2007, the Company recorded a \$2.1 million gain on its junior subordinated debt, primarily resulting from an overall deterioration of the credit markets during the third quarter of 2007 which increased pricing spreads from base rates on similar debt instruments.

The Company continues to emphasize relationship banking and core deposit growth, and has focused greater attention on its market area of Fresno, Madera, and Kern Counties, as well as its new market area of Campbell, in Santa Clara County. The San Joaquin Valley and other California markets continue to benefit from construction lending and commercial loan demand from small and medium size businesses, although commercial and residential real estate markets have softened during 2007. On average, loans have increased nearly \$110.1 million between the nine-month periods ended September 30, 2006 and September 30, 2007, and end-of-period loans have increased more than \$126.6 million between September 30, 2006 and September 30, 2007. Growth continues primarily in commercial and industrial loans, and commercial real estate loans, and to a lesser degree in construction loans and agricultural loans. In the future, the Company will continue to maintain an emphasis on its core lending strengths of commercial real estate and construction lending, as well as small business financing, while expanding opportunities in agricultural, installment, and other loan categories when possible. The third quarter did present challenges with credit tightening, weakening real estate markets, and loan losses affecting the loan portfolio. The charge-off of a \$1.6 million land development loan during the third quarter of 2007, combined with an increase in impaired loans, necessitated an additional \$1.7 million in loan loss provision for the quarter. Additionally, OREO increased \$563,000 during the third quarter resulting from the transfer of a single loan relationship to foreclosed property. As a result, nonperforming assets as a percentage of total assets increased from 2.19% at December 31, 2006 to 2.45% at September 30, 2007.

The Company continually evaluates its strategic business plan as economic and market factors change in its market area. Growth and increasing market share will be of primary importance during the remainder of 2007 and beyond. The Company is excited about its recent merger with Legacy Bank located in Campbell, California. This new acquisition brings additional opportunities in a dynamic new market, and will enable the Company to expand its ability to serve Legacy's current clients and increase lending capabilities in the market area of Santa Clara County. During the fourth quarter of 2006, the Company relocated its administrative headquarters to downtown Fresno, thus increasing its presence there. The banking industry has recently experienced pressures on net margins as well as asset quality resulting from concerns in the sub-prime real estate market, and a general deterioration in credit markets. As a result, market rates of interest and asset quality will continue be an important factor in the Company's ongoing strategic planning process, as it is predicted that we are near the end of an interest rate cycle.

### **Results of Operations**

For the nine months ended September 30, 2007, the Company reported net income of \$10.6 million or \$0.89 per share (\$0.88 diluted) as compared to \$10.4 million or \$0.91 per share (\$0.91 diluted) for the nine months ended September 30, 2006. The Company's return on average assets was 1.87% for the nine-month-period ended September 30, 2007 as

compared to 2.14% for the nine-month-period ended September 30, 2006. The Bank's return on average equity was 17.43% for the nine months ended September 30, 2007 as compared to 22.12% for the same -month period of 2006.

**Net Interest Income**

Net interest income before provision for credit losses totaled \$27.8 million for the nine months ended September 30, 2007, representing an increase of \$3.3 million or 13.6% when compared to the \$24.5 million reported for the same nine months of the previous year. The increase in net interest income between 2006 and 2007 is primarily the result of increased volumes in, and yields on, interest-earning assets, which more than offset increases in the Company's cost of interest-bearing liabilities.

The Bank's net interest margin, as shown in Table 1, decreased to 5.50% at September 30, 2007 from 5.66% at September 30, 2006, a decrease of 16 basis point (100 basis points = 1%) between the two periods. Although the Company has experienced pricing pressures on loans over the past year, average market rates of interest increased between the nine-month periods ended September 30, 2006 and 2007. The prime rate averaged 8.23% for the nine months ended September 30, 2007 as compared to 7.86% for the comparative nine months of 2006. While yields on earning assets increased between the two periods presented, costs of interest-bearing liabilities increased more, increasing 80 basis points between the two nine-month periods.

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

Interest rates and Interest Differentials

Nine Months Ended September 30, 2007 and 2006

(dollars in thousands)	Average Balance	2007 Interest	Yield/ Rate	Average Balance	2006 Interest	Yield/ Rate
<b>Assets:</b>						
Interest-earning assets:						
Loans and leases (1)	\$ 569,730	\$ 39,542	9.28%	\$ 459,640	\$ 31,136	9.06%
Investment Securities - taxable	90,466	2,882	4.26%	90,465	2,450	3.62%
Investment Securities - nontaxable (2)	2,227	81	4.86%	2,226	81	4.87%
Interest-bearing deposits in other banks	7,762	223	3.84%	7,741	243	4.20%
Federal funds sold and reverse repos	4,485	183	5.46%	17,307	599	4.63%
Total interest-earning assets	674,670	\$ 42,911	8.50%	577,379	\$ 34,509	7.99%
Allowance for credit losses	(9,648)			(8,035)		
Noninterest-bearing assets:						
Cash and due from banks	24,587			27,015		
Premises and equipment, net	15,950			12,102		
Accrued interest receivable	4,187			3,549		
Other real estate owned	1,953			3,837		
Other assets	42,411			33,137		
Total average assets	\$ 754,110			\$ 648,984		
<b>Liabilities and Shareholders' Equity:</b>						
Interest-bearing liabilities:						
NOW accounts	\$ 46,675	\$ 221	0.63%	\$ 50,000	\$ 220	0.59%
Money market accounts	140,337	3,271	3.12%	135,568	2,572	2.54%
Savings accounts	47,384	691	1.95%	35,429	144	0.54%

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Time deposits	250,983	9,299	4.95%	191,380	5,898	4.12%
Other borrowings	16,513	657	5.32%	5,531	219	5.29%
Junior subordinated debentures	16,272	984	8.09%	15,464	996	8.61%
Total interest-bearing liabilities	518,164	\$ 15,123	3.90%	433,372	\$ 10,049	3.10%
Noninterest-bearing liabilities:						
Noninterest-bearing checking	145,471			145,443		
Accrued interest payable	2,238			1,890		
Other liabilities	7,185			5,490		
Total Liabilities	673,058			586,195		
Total shareholders' equity	81,052			62,789		
Total average liabilities and shareholders' equity	\$ 754,110			\$ 648,984		
Interest income as a percentage of average earning assets			8.50%			7.99%
Interest expense as a percentage of average earning assets			3.00%			2.33%
Net interest margin			5.50%			5.66%

- (1) Loan amounts include nonaccrual loans, but the related interest income has been included only if collected for the period prior to the loan being placed on a nonaccrual basis. Loan interest income includes loan fees of approximately \$2,285,000 and \$2,529,000 for the nine months ended September 30, 2007 and 2006, respectively.
- (2) Applicable nontaxable securities yields have not been calculated on a tax-equivalent basis because they are not material to the Company's results of operations.

Both the Company's net interest income and net interest margin are affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as "volume change." Both are also affected by changes in yields on interest-earning assets and rates paid on interest-bearing liabilities, referred to as "rate change". The following table sets forth the changes in interest income and interest expense for each major category of interest-earning asset and interest-bearing liability, and the amount of change attributable to volume and rate changes for the periods indicated.

Table 2. Rate and Volume Analysis

<i>(In thousands)</i>	Increase (decrease) in the nine months ended Sept 30, 2007 compared to Sept 30, 2006		
	Total	Rate	Volume
<b>Increase (decrease) in interest income:</b>			
Loans and leases	\$ 8,406	\$ 782	\$ 7,624
Investment securities available for sale	432	432	0
Interest-bearing deposits in other banks	(20)	(21)	1
Federal funds sold and securities purchased under agreements to resell	(416)	92	(508)
<b>Total interest income</b>	<b>8,402</b>	<b>1,285</b>	<b>7,117</b>
<b>Increase (decrease) in interest expense:</b>			
Interest-bearing demand accounts	700	678	22
Savings accounts	547	484	63
Time deposits	3,401	1,339	2,062
Other borrowings	438	1	437
Subordinated debentures	(12)	(63)	51
<b>Total interest expense</b>	<b>5,074</b>	<b>2,439</b>	<b>2,635</b>
<b>Increase (decrease) in net interest income</b>	<b>\$ 3,328</b>	<b>\$ (1,154)</b>	<b>\$ 4,482</b>

For the nine months ended September 30, 2007, total interest income increased approximately \$8.4 million or 24.4% as compared to the nine-month period ended September 30, 2006. Earning asset volumes increased almost exclusively in loans, while volumes decreased moderately in federal funds sold.

For the nine months ended September 30, 2007, total interest expense increased approximately \$5.1 million or 50.5% as compared to the nine-month period ended September 30, 2006. Between those two periods, average interest-bearing liabilities increased by \$84.8 million, while the average rates paid on those liabilities increased by 80 basis points.

Provisions for credit losses are determined on the basis of management's periodic credit review of the loan portfolio, consideration of past loan loss experience, current and future economic conditions, and other pertinent factors. Such factors consider the allowance for credit losses to be adequate when it covers estimated losses inherent in the loan portfolio. Based on the condition of the loan portfolio, management believes the allowance is sufficient to cover risk elements in the loan portfolio. For the nine months ending September 30, 2007, the provision to the allowance for

credit losses amounted to \$2.4 million as compared to \$639,000 for the nine months ended September 30, 2006. Additional provisions taken during the third quarter of 2007 were the result of a charge-off of a land development loan totaling \$1.6 million, as well as an increase in nonperforming loans during the quarter. The amount provided to the allowance for credit losses during the first nine months brought the allowance to 1.62% of net outstanding loan balances at September 30, 2007, as compared to 1.67% of net outstanding loan balances at December 31, 2006, and 1.61% at September 30, 2006.

**Noninterest Income****Table 3. Changes in Noninterest Income**

The following table sets forth the amount and percentage changes in the categories presented for the nine months ended September 30, 2007 as compared to the nine months ended September, 2006:

<i>(In thousands)</i>	2007	2006	Amount of Change	Percent Change
Customer service fees	\$ 3,503	\$ 2,905	\$ 598	20.59%
Gain on sale of OREO	35	38	(3)	-7.89%
Gain on proceeds from life insurance	483	482	1	0.21%
Gain (loss) on swap ineffectiveness	44	(94)	138	146.81%
Gain on fair value of financial liabilities	2,234	0	2,234	—
Gain on sale of investment	0	1,877	(1,877)	-100.00%
Gain on sale of fixed assets	2	1,012	(1,010)	-99.80%
Shared appreciation income	34	0	34	—
Other	1,219	912	307	33.66%
Total noninterest income	\$ 7,554	\$ 7,132	\$ 422	5.92%

Noninterest income for the nine months ended September 30, 2007 increased \$422,000 or 5.9% when compared to the same period of 2006. Net increases in total noninterest income experienced during 2007 were the primarily the result of a \$2.2 million gain recognized on the change in fair value to the Company's junior subordinated debt. With the recent deterioration in credit markets, the rate on the Company's junior subordinated debt was far below current market rates of interest on similar instruments, resulting in the significant gain recorded at September 30, 2007. This was offset by a decline in gain on sale of investments, and gain on sale of fixed assets. Declines in gain on sale of investments resulted from a \$1.8 million gain on the sale of an investment in correspondent bank during the first quarter of 2006, which was not again experienced during 2007. Declines in gain on sale of fixed assets resulted from a \$1 million gain on the sale of the Company's administrative headquarters during the third quarter of 2006, which was not again experienced during 2007. Customer service fees increased \$598,000 or 20.6% between the two nine-month periods presented, which is attributable in large part to increases in ATM income, but is also attributable to increases in DDA analysis fees and NSF fees. Increases in other noninterest income of \$307,000 or 33.7% between the nine-month periods ended September 2006 and 2007, were the result of a number of items including increases in rental and OREO income experienced during the first nine months of 2007.

**Noninterest Expense**

The following table sets forth the amount and percentage changes in the categories presented for the nine months ended September 30, 2007 as compared to the nine months ended September 30, 2006:

**Table 4. Changes in Noninterest Expense**

<i>(In thousands)</i>	2007	2006	Amount of Change	Percent Change
Salaries and employee benefits	\$ 7,972	\$ 7,118	\$ 854	12.00%
Occupancy expense	2,662	1,859	803	43.20%
Data processing	326	372	(46)	-12.37%
Professional fees	1,251	664	587	88.40%



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Directors fees	201	167	34	20.36%
Amortization of intangibles	740	403	337	83.62%
Correspondent bank service charges	343	153	190	124.18%
Loss on California tax credit partnership	324	330	(6)	-1.82%
OREO expense	118	1,804	(1,686)	-93.46%
Other	2,072	1,774	298	16.80%
Total expense	\$ 16,009	\$ 14,644	\$ 1,365	9.32%

Increases in noninterest expense between the nine months ended September 30, 2006 and 2007 are associated primarily with normal continued growth of the Company, including additional staffing costs, and costs associated with the new branch operations in Campbell, California, resulting from the merger with Legacy Bank. Increases in professional fees experienced during 2007 were the result of additional legal fees incurred for impaired loans and general corporate purposes, as well as increased audit fees. Decreases in OREO expense were the result of additional expenses, including disposal and clean-up costs, incurred during 2006 on a single OREO property, which was in the process of liquidation.

Pursuant to the adoption of SFAS No. 123R during the first quarter of 2006, the Company recognized stock-based compensation expense of \$140,000 and \$175,000 for the nine months ended September 30, 2007 and 2006, respectively. This expense is included in noninterest expense under salaries and employee benefits. The Company expects stock-based compensation expense to be about \$48,000 per quarter during the remainder of 2007. Under the current pool of stock options, stock-based compensation expense will decline to approximately \$30,000 per quarter during 2008, then to \$17,000 per quarter for 2009, and decline after that through 2011. If new stock options are issued, or existing options fail to vest, for example, due to forfeiture, actual stock-based compensation expense in future periods will change.

### ***Income Taxes***

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

During the first quarter of 2005, the FTB notified the Company of its intent to audit the REIT for the tax years ended December 2001 and 2002. The Company has retained legal counsel to represent it in the tax audit, and counsel has provided the FTB with documentation supporting the Company's position. The FTB concluded its audit during January 2006. During April 2006, the FTB issued a Notice of Proposed Assessment to the Company, which included proposed tax and penalty assessments related to the tax benefits taken for the REIT during 2002. The Company still believes the case has merit based upon the fact that the FTB is ignoring certain facts of law in the case. The issuance of the Notice of Proposed Assessment by the FTB will not end the administrative processing of the REIT issue because the Company has asserted its administrative protest and appeal rights pending the outcome of litigation by another taxpayer presently in process on the REIT issue in the Los Angeles Superior Court (*City National v. Franchise Tax Board*). The case is ongoing and may take several years to complete.

On January 1, 2007 the Company adopted Financial Accounting Standards Board (FASB) Interpretation 48 (FIN 48), "Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109". FIN 48 clarifies SFAS No. 109, "Accounting for Income Taxes", to indicate a criterion that an individual tax position would have to meet for some or all of the income tax benefit to be recognized in a taxable entity's financial statements. Under the guidelines of FIN48, an entity should recognize the financial statement benefit of a tax position if it determines that it is *more likely than not* that the position will be sustained on examination. The term "more likely than not" means a likelihood of more than 50 percent." In assessing whether the more-likely-than-not criterion is met, the entity should assume that the tax position will be reviewed by the applicable taxing authority.

The Company has reviewed its REIT tax position as of January 1, 2007 (adoption date), and then again at March 31<sup>st</sup> and June 30<sup>th</sup>, 2007 in light of the adoption of FIN48. The Bank, with guidance from advisors believes that the case has merit with regard to points of law, and that the tax law at the time allowed for the deduction of the consent

dividend. However, the Bank, with the concurrence of advisors, cannot conclude that it is “more than likely” (as defined in FIN48) that the Bank will prevail in its case with the FTB. As a result of this determination, effective January 1, 2007 the Company recorded an adjustment of \$1,299,000 to beginning retained earnings upon adoption of FIN48 to recognize the potential tax liability under the guidelines of the interpretation. The adjustment includes amounts for assessed taxes, penalties, and interest. During the nine months ended September 30, 2007, the Company increased the unrecognized tax liability by an additional \$43,000 in interest for the period, bringing the total recorded tax liability under FIN48 to \$1,341,000 at September 30, 2007. It is the Company’s policy to recognize interest and penalties under FIN48 as a component of income tax expense.

**Financial Condition**

Total assets increased \$124.7 million or 18.38% to a balance of \$803.0 million at September 30, 2007, from the balance of \$678.3 million at December 31, 2006, and increased \$125.0 million or 18.43% from the balance of \$678.0 million at September 30, 2006. Total deposits of \$669.5 million at September 30, 2007 increased \$82.4 million or 14.03% from the balance reported at December 31, 2006, and increased \$79.4 million from the balance of \$590.1 million reported at September 30, 2006. Between December 31, 2006 and September 30, 2007, loan growth totaled \$125.4 million or 25.05%, while securities increased by \$5.3 million or 6.35%, and other short-term investments decreased \$15.2 million as these funds were utilized to fund loan growth.

Earning assets averaged approximately \$674.7 million during the nine months ended September 30, 2007, as compared to \$577.45 million for the same nine-month period of 2006. Average interest-bearing liabilities increased to \$518.2 million for the nine months ended September 30, 2007, as compared to \$433.4 million for the comparative nine-month period of 2006.

***Loans and Leases***

The Company's primary business is that of acquiring deposits and making loans, with the loan portfolio representing the largest and most important component of its earning assets. Loans totaled \$628.6 million at September 30, 2007, an increase of \$125.4 million or 25.1% when compared to the balance of \$500.6 million at December 31, 2006, and an increase of \$126.6 million or 25.4% when compared to the balance of \$499.3 million reported at September 30, 2006. Loans on average increased 24.0% between the nine-month periods ended September 30, 2006 and September 30, 2007, with loans averaging \$674.7 million for the nine months ended September 30, 2007, as compared to \$577.4 million for the same nine-month period of 2006.

During the first nine months of 2007, increases were experienced in all loan categories except lease financing, with the strongest growth in the Company's core lending categories of commercial and industrial loans, and commercial real estate, with lesser increases in construction loans and agricultural loans. The following table sets forth the amounts of loans outstanding by category at September 30, 2007 and December 31, 2006, the category percentages as of those dates, and the net change between the two periods presented.

**Table 5. Loans**

<i>(In thousands)</i>	September 30, 2007		December 31, 2006		Net Change	% Change
	Dollar Amount	% of Loans	Dollar Amount	% of Loans		
Commercial and industrial	\$ 207,123	33.2%	\$ 155,811	31.1%	\$ 51,312	32.93%
Real estate - mortgage	150,274	24.0%	113,613	22.7%	36,661	32.27%
Real estate - construction	186,147	29.7%	168,378	33.7%	17,769	10.55%
Agricultural	53,277	8.5%	35,102	7.0%	18,175	51.78%
Installment/other	19,496	3.1%	16,712	3.3%	2,784	16.66%
Lease financing	9,631	1.5%	10,952	2.2%	(1,321)	-12.07%
<b>Total Gross Loans</b>	<b>\$ 625,948</b>	<b>100.0%</b>	<b>\$ 500,568</b>	<b>100.0%</b>	<b>\$ 125,380</b>	<b>25.05%</b>

The overall average yield on the loan portfolio was 9.28% for the nine months ended September 30, 2007 as compared to 9.06% for the nine months ended September 30, 2006, and increased between the two periods primarily as the result of an increase in average market rates of interest which positively impacted loan yields. The loan yield realized during the first nine months of 2007 was enhanced to some degree as the result of a nonperforming loan that was paid

off during the quarter, providing an additional \$902,000 in previously unrecognized interest income, and an increase in loan yield for 2007 of approximately 0.21%. At September 30, 2007, 63.0% of the Company's loan portfolio consisted of floating rate instruments, as compared to 59.5% of the portfolio at December 31, 2006, with the majority of those tied to the prime rate.

Loans acquired in the acquisition of Legacy Bank totaled approximately \$63.9 million at the date of merger (February 16, 2007). Exclusive of the loans acquired from Legacy Bank during the first quarter, loan balances attributable to the Company's previously existing loan portfolio increased approximately \$61.5 million during the nine months ended September 30, 2007. The following table shows the net change experienced during the nine months ended September 30, 2007, removing the effect of the loans acquired in the Legacy Bank merger.

	Total Loans Sept 30, 2007	Legacy Loans at merger	Sept 30, 2007 Loans without Legacy Loans	Net Change Nine Months Ended Sept 30, 2007 (1)
Commercial and industrial	\$ 207,123	\$ 31,735	\$ 175,388	\$ 19,577
Real estate - mortgage	150,274	14,417	135,857	22,244
Real estate - construction	186,147	12,817	173,330	4,952
Agricultural	53,277	0	53,277	18,175
Installment/other	19,496	4,957	14,539	(2,173)
Lease financing	9,631	0	9,631	(1,321)
<b>Total Loans</b>	<b>\$ 625,948</b>	<b>\$ 63,926</b>	<b>\$ 562,022</b>	<b>\$ 61,454</b>

(1) Net change in loans between December 31, 2006 and September 30, 2007, excluding balance of loans acquired from Legacy Bank at merger date (2/16/07).

### Deposits

Total deposits increased during the period to a balance of \$669.5 million at September 30, 2007 representing an increase of \$88.6 million or 14.03% from the balance of \$587.1 million reported at December 31, 2006, and an increase of \$79.4 million or 13.45% from the balance reported at September 30, 2006. During the first nine months of 2007, increases were experienced in all deposit categories except noninterest-bearing checking accounts.

The following table sets forth the amounts of deposits outstanding by category at September 30, 2007 and December 31, 2006, and the net change between the two periods presented.

Table 6. Deposits

(In thousands)	Sept 30, 2007	December 31, 2006	Net Change	Percentage Change
Noninterest bearing deposits	\$ 152,787	\$ 159,002	(\$6,215)	-3.91%
Interest bearing deposits:				
NOW and money market accounts	184,465	184,384	81	0.04%
Savings accounts	45,448	31,933	13,515	42.32%
Time deposits:				
Under \$100,000	47,797	42,428	5,369	12.66%
\$100,000 and over	239,031	169,380	69,651	41.12%
Total interest bearing deposits	516,741	428,125	88,616	20.70%
<b>Total deposits</b>	<b>\$ 669,528</b>	<b>\$ 587,127</b>	<b>\$ 82,401</b>	<b>14.03%</b>

The Company's deposit base consists of two major components represented by noninterest-bearing (demand) deposits and interest-bearing deposits. Interest-bearing deposits consist of time certificates, NOW and money market accounts and savings deposits. Total interest-bearing deposits increased \$88.6 million or 20.70% between December 31, 2006 and September 30, 2007, while noninterest-bearing deposits decreased \$6.2 million or 3.91% between the same two periods presented. Core deposits, consisting of all deposits other than time deposits of \$100,000 or more, and brokered deposits, continue to provide the foundation for the Company's principal sources of funding and liquidity. These core deposits amounted to 63.9% and 70.9% of the total deposit portfolio at September 30, 2007 and December 31, 2006, respectively.

On a year-to-date average (refer to Table 1), the Company experienced an increase of \$73.0 million or 13.09% in total deposits between the nine-month periods ended September 30, 2006 and September 30, 2007. Between these two

periods, average interest-bearing deposits increased \$73.0 million or 17.70%, while total noninterest-bearing checking increased \$28,000 or 0.02% on a year-to-date average basis.

Deposit balances acquired in the acquisition of Legacy Bank totaled approximately \$69.6 million at the date of merger (February 16, 2007). Exclusive of the deposits acquired from Legacy Bank during the first quarter, deposit balances attributable to the Company's previously existing deposit base increased approximately \$12.8 million during the nine months ended September 30, 2007. The following table shows the net change experienced during the six months ended September 30, 2007, removing the effect of the deposit balances acquired in the Legacy Bank merger.

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	Total Deposits Sept 30, 2007	Legacy Deposits at merger	Sept 30, 2007 Deposits Without Legacy	Net Change Nine Months Ended 9/30/07 (1)
Noninterest bearing deposits	\$ 152,787	\$ 17,970	\$ 134,817	\$ (24,185)
<b>Interest bearing deposits:</b>				
NOW and money market accounts	184,465	10,541	173,924	(10,460)
Savings accounts	45,448	28,752	16,696	(15,237)
<b>Time deposits:</b>				
Under \$100,000	47,797	2,860	44,937	2,509
\$100,000 and over	239,031	9,477	229,554	60,174
Total interest bearing deposits	516,741	51,630	465,111	36,986
<b>Total deposits</b>	<b>\$ 669,528</b>	<b>\$ 69,600</b>	<b>\$ 599,928</b>	<b>\$ 12,801</b>

(1) Net change between December 31, 2006 and September 30, 2007 in deposit balances, excluding deposits acquired from Legacy Bank at merger date (2/16/07).

### ***Short-Term Borrowings***

The Company had collateralized and uncollateralized lines of credit aggregating \$385.4 million, as well as FHLB lines of credit totaling \$22.2 million at September 30, 2007. These lines of credit generally have interest rates tied to the Federal Funds rate or are indexed to short-term U.S. Treasury rates or LIBOR. All lines of credit are on an "as available" basis and can be revoked by the grantor at any time. At September 30, 2007, the Company had \$20 million borrowed against its FHLB line of credit. Of the \$20.0 million in FHLB borrowings outstanding at September 30, 2007, \$10.0 million was in overnight borrowings, and the other \$10.0 million consists of a two-year FHLB advance, at a fixed rate of 4.92%, and a maturity date of March 30, 2009. The Company had collateralized and uncollateralized lines of credit aggregating \$308.3 million, as well as FHLB lines of credit totaling \$28.0 million at December 31, 2006.

### ***Asset Quality and Allowance for Credit Losses***

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

The allowance for credit losses is maintained at a level deemed appropriate by management to provide for known and inherent risks in existing loans and commitments to extend credit. The adequacy of the allowance for credit losses is based upon management's continuing assessment of various factors affecting the collectibility of loans and commitments to extend credit; including current economic conditions, past credit experience, collateral, and concentrations of credit. There is no precise method of predicting specific losses or amounts which may ultimately be charged off on particular segments of the loan portfolio. The conclusion that a loan may become uncollectible, either in part or in whole is judgmental and subject to economic, environmental, and other conditions which cannot be predicted with certainty. When determining the adequacy of the allowance for credit losses, the Company follows, in accordance with GAAP, the guidelines set forth in the Revised Interagency Policy Statement on the Allowance for Loan and Lease Losses ("Statement") issued by banking regulators during December 2006. The Statement is a revision of the previous guidance released in July 2001, and outlines characteristics that should be used in segmentation of the loan portfolio for purposes of the analysis including risk classification, past due status, type of loan, industry or



collateral. It also outlines factors to consider when adjusting the loss factors for various segments of the loan portfolio, and updates previous guidance that describes the responsibilities of the board of directors, management, and bank examiners regarding the allowance for credit losses. Securities and Exchange Commission Staff Accounting Bulletin No. 102 was released during July 2001, and represents the SEC staff's view relating to methodologies and supporting documentation for the Allowance for Loan and Lease Losses that should be observed by all public companies in complying with the federal securities laws and the Commission's interpretations. It is also generally consistent with the guidance published by the banking regulators. The Company segments the loan and lease portfolio into eleven (11) segments, primarily by loan class and type, that have homogeneity and commonality of purpose and terms for analysis under SFAS No. 5. Those loans, which are determined to be impaired under SFAS No. 114, are not subject to the general reserve analysis under SFAS No. 5, and evaluated individually for specific impairment.

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

- the formula allowance,
- specific allowances for problem graded loans ("classified loans")
- and the unallocated allowance

In addition, the allowance analysis also incorporates the results of measuring impaired loans as provided in:

- Statement of Financial Accounting Standards ("SFAS") No. 114, "Accounting by Creditors for Impairment of a Loan" and
- SFAS 118, "Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures."

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

Specific allowances are established based on management's periodic evaluation of loss exposure inherent in classified loans, impaired loans, and other loans in which management believes there is a probability that a loss has been incurred in excess of the amount determined by the application of the formula allowance.

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

The Company's methodology includes features that are intended to reduce the difference between estimated and actual losses. The specific allowance portion of the analysis is designed to be self-correcting by taking into account the current loan loss experience based on that portion of the portfolio. By analyzing the probable estimated losses inherent in the loan portfolio on a quarterly basis, management is able to adjust specific and inherent loss estimates using the most recent information available. In performing the periodic migration analysis, management believes that historical loss factors used in the computation of the formula allowance need to be adjusted to reflect current changes in market conditions and trends in the Company's loan portfolio. There are a number of other factors which are reviewed when determining adjustments in the historical loss factors. They include 1) trends in delinquent and nonaccrual loans, 2) trends in loan volume and terms, 3) effects of changes in lending policies, 4) concentrations of credit, 5) competition, 6) national and local economic trends and conditions, 7) experience of lending staff, 8) loan review and Board of Directors oversight, 9) high balance loan concentrations, and 10) other business conditions. During the first nine months of 2007, there were no changes in estimation methods or assumptions that affected the methodology for assessing the adequacy of the allowance for credit losses.

Management and the Company's lending officers evaluate the loss exposure of classified and impaired loans on a weekly/monthly basis and through discussions and officer meetings as conditions change. The Company's Loan Committee meets weekly and serves as a forum to discuss specific problem assets that pose significant concerns to the Company, and to keep the Board of Directors informed through committee minutes. All special mention and classified loans are reported quarterly on Criticized Asset Reports which are reviewed by senior management. With this information, the migration analysis and the impaired loan analysis are performed on a quarterly basis and adjustments are made to the allowance as deemed necessary.

Impaired loans are calculated under SFAS No. 114, and are measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. The amount of impaired loans is not directly comparable to the amount of nonperforming loans disclosed later in this section. The primary differences between impaired loans and nonperforming loans are: i) all loan categories are considered in determining nonperforming loans while impaired loan recognition is limited to commercial and industrial loans, commercial and residential real estate loans, construction loans, and agricultural loans, and ii) impaired loan recognition considers not only loans 90 days or more past due, restructured loans and nonaccrual loans but also may include problem loans other than delinquent loans.

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

At September 30, 2007 and 2006, the Company's recorded investment in loans for which impairment has been recognized totaled \$23.1 million and \$8.8 million, respectively. Included in total impaired loans at September 30, 2007, are \$12.9 million of impaired loans for which the related specific allowance is \$5.2 million, as well as \$10.2 million of impaired loans that as a result of write-downs or the fair value of the collateral, did not have a specific allowance. Impaired loans increased during the third quarter of 2007 primarily as the result of a single land development purchased participation loan totaling approximately \$6.5 million. The impaired loan is secured by land and residential real estate lots, but the borrower has indicated that future payments may not be made on a consistent basis. At September 30, 2007 there was no impairment reserve on this participation loan relationship. The Company is currently monitoring this credit closely to determine a proper resolution. Total impaired loans at September 30, 2006 included \$5.5 million of impaired loans for which the related specific allowance is \$3.9 million, as well as \$3.3 million of impaired loans that, as a result of write-downs or the fair value of the collateral, did not have a specific allowance. The average recorded investment in impaired loans was \$14.7 million during the first nine months of 2007 and \$10.4 million during the first nine months of 2006. In most cases, the Bank uses the cash basis method of income recognition for impaired loans. In the case of certain troubled debt restructuring, for which the loan is performing under the current contractual terms, income is recognized under the accrual method. For the nine months ended September 30, 2007, the Company recognized no income on such loans. For the year ended December 31, 2006 and the nine months ended September 30, 2006, the Company recognized \$65,000 and \$35,000, respectively, in income on such loans.

The Company focuses on competition and other economic conditions within its market area, which may ultimately affect the risk assessment of the portfolio. The Company continues to experience increased competition from major banks, local independents and non-bank institutions creating pressure on loan pricing. With interest rates decreasing 50 basis points during September 2007, indications are that rates will continue to drop in the near future as a result of sub-prime lending problems, a weakened real estate market, and tightening credit markets. Both business and consumer spending have improved during the past several years, but current GDP projections for the next year have softened. It is difficult to determine to what degree the Federal Reserve adjust short-term interest rates in its efforts to influence the economy. It is likely that the business environment in California will continue to be influenced by these domestic as well as global events. The local market has improved economically during the past several years while the rest of the state and the nation have experienced slowed economic growth. Although the local area residential housing markets have softened to some degree, they continue to perform, which should bode well for sustained growth in the Company's market areas of Fresno and Madera, Kern, and Santa Clara Counties. Local unemployment rates in the San Joaquin Valley remain high primarily as a result of the areas' agricultural dynamics, however unemployment rates

have improved during the past several years. It is difficult to predict what impact this will have on the local economy. The Company believes that the Central San Joaquin Valley will continue to grow and diversify as property and housing costs remain reasonable relative to other areas of the state. Management recognizes increased risk of loss due to the Company's exposure from local and worldwide economic conditions, as well as potentially volatile real estate markets, and takes these factors into consideration when analyzing the adequacy of the allowance for credit losses.

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

Table 7. Allowance for Credit Losses - Summary of Activity (unaudited)

<i>(In thousands)</i>	September 30, 2007	September 30, 2006
Total loans outstanding at end of period before deducting allowances for credit losses	\$ 624,091	\$ 498,333
Average net loans outstanding during period	569,730	459,640
Balance of allowance at beginning of period	8,365	7,748
Loans charged off:		
Real estate	0	0
Commercial and industrial	(1,793)	(290)
Lease financing	(8)	(149)
Installment and other	(115)	(36)
Total loans charged off	(1,916)	(475)
Recoveries of loans previously charged off:		
Real estate	0	0
Commercial and industrial	27	63
Lease financing	0	1
Installment and other	17	29
Total loan recoveries	44	93
Net loans charged off	(1,872)	(382)
Provision charged to operating expense	2,360	639
Reserve acquired in business combination	1,268	0
Balance of allowance for credit losses at end of period	\$ 10,121	\$ 8,005
Net loan charge-offs to total average loans (annualized)	0.44%	0.11%
Net loan charge-offs to loans at end of period (annualized)	0.40%	0.10%
Allowance for credit losses to total loans at end of period	1.62%	1.61%
Net loan charge-offs to allowance for credit losses (annualized)	24.73%	6.38%
Net loan charge-offs to provision for credit losses (annualized)	79.32%	59.78%

At September 30, 2007 and 2006, \$609,000 and \$516,000, respectively, of the formula allowance is allocated to unfunded loan commitments and is, therefore, carried separately in other liabilities. Management believes that the 1.62% credit loss allowance at September 30, 2007 is adequate to absorb known and inherent risks in the loan portfolio. No assurance can be given, however, that the economic conditions which may adversely affect the Company's service areas or other circumstances will not be reflected in increased losses in the loan portfolio.

It is the Company's policy to discontinue the accrual of interest income on loans for which reasonable doubt exists with respect to the timely collectibility of interest or principal due to the ability of the borrower to comply with the terms of the loan agreement. Such loans are placed on nonaccrual status whenever the payment of principal or interest is 90 days past due or earlier when the conditions warrant, and interest collected is thereafter credited to principal to

the extent necessary to eliminate doubt as to the collectibility of the net carrying amount of the loan. Management may grant exceptions to this policy if the loans are well secured and in the process of collection.

Table 8. Nonperforming Assets

<i>(In thousands)</i>	September 30, 2007	December 31, 2006
Nonaccrual Loans	\$ 17,141	\$ 8,138
Restructured Loans	71	4,906
Total nonperforming loans	17,212	13,044
Other real estate owned	2,482	1,919
Total nonperforming assets	\$ 19,694	\$ 14,963
Loans past due 90 days or more, still accruing	\$ 0	\$ 0
Nonperforming loans to total gross loans	2.75%	2.61%
Nonperforming assets to total gross loans	3.15%	2.99%

Nonaccrual loans have increased between December 31, 2006 and September 30, 2007 as the result of the transfer of two lending relationships to nonaccrual status during the first nine months of 2007, one of those relationships totaling more than \$7.6 million. Of that \$7.6 million relationship, \$6.0 million is a land development loan which is a shared appreciation credit, and as such, the Company has agreed to receive interest on the loan as lots are sold rather than monthly, and the borrower has agreed to share in the profits of the project. Interest is accrued and recognized in income on an ongoing basis. Shared appreciation profit is currently established at \$22,000 per lot. Upon moving the credit to nonaccrual status during the first quarter of 2007, the Company did not reverse the accrued interest amount of \$865,000 from income, based upon the current appraised value of the property and the additional values estimated of the 177 completed lots (see "Asset Quality and Allowance for Credit Losses" section of Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's December 31, 2006 10-K). At this time, the Company believes that based upon such values, it will collect all principal and interest due on the loan.

A \$4.9 million loan classified as restructured at December 31, 2006, paid off during the first quarter of 2007, resulting in the recognition of approximately \$1.1 million in previously unrecognized interest income during the nine months ended September 30, 2007.

The Company purchased a schedule of payments collateralized by Surety Bonds and lease payments in September 2001 that have a current balance owing of \$5.4 million plus interest. The leases have been nonperforming since June 2002 (see "Asset Quality and Allowance for Credit Losses" section of Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the Company's 2006 Annual Report on Form 10-K). The impaired lease portfolio is on non-accrual status and has a specific allowance allocation of \$4.2 million and \$4.0 million allocated at September 30, 2007 and December 31, 2006, and a net carrying value of \$1.2 million and \$1.4 million at September 30, 2007 and December 31, 2006, respectively. The specific allowance was determined based on an estimate of expected future cash flows.

The Company believes that under generally accepted accounting principles a total loss of principal is not probable, and the specific allowance of \$4.2 million calculated for the impaired lease portfolio at September 30, 2007 under SFAS No. 114 is in accordance with generally accepted accounting principles.

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

Except for the loans included in the above table, or those otherwise included in the impaired loan totals, there were no loans at September 30, 2007 where the known credit problems of a borrower caused the Company to have serious doubts as to the ability of such borrower to comply with the present loan repayment terms and which would result in such loan being included as a nonaccrual, past due or restructured loan at some future date.

#### **Asset/Liability Management – Liquidity and Cash Flow**

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

##### *Liquidity*

Liquidity management may be described as the ability to maintain sufficient cash flows to fulfill financial obligations, including loan funding commitments and customer deposit withdrawals, without straining the Company's equity structure. To maintain an adequate liquidity position, the Company relies on, in addition to cash and cash equivalents,



cash inflows from deposits and short-term borrowings, repayments of principal on loans and investments, and interest income received. The Company's principal cash outflows are for loan origination, purchases of investment securities, depositor withdrawals and payment of operating expenses.

The Company continues to emphasize liability management as part of its overall asset/liability strategy. Through the discretionary acquisition of short term borrowings, the Company has been able to provide liquidity to fund asset growth while, at the same time, better utilizing its capital resources, and better controlling interest rate risk. The borrowings are generally short-term and more closely match the repricing characteristics of floating rate loans, which comprise approximately 63.0% of the Company's loan portfolio at September 30, 2007. This does not preclude the Company from selling assets such as investment securities to fund liquidity needs but, with favorable borrowing rates, the Company has maintained a positive yield spread between borrowed liabilities and the assets which those liabilities fund. If, at some time, rate spreads become unfavorable, the Company has the ability to utilize an asset management approach and, either control asset growth or, fund further growth with maturities or sales of investment securities.

The Company's liquid asset base which generally consists of cash and due from banks, federal funds sold, securities purchased under agreements to resell ("reverse repos") and investment securities, is maintained at a level deemed sufficient to provide the cash outlay necessary to fund loan growth as well as any customer deposit runoff that may occur. Within this framework is the objective of maximizing the yield on earning assets. This is generally achieved by maintaining a high percentage of earning assets in loans, which historically have represented the Company's highest yielding asset. At September 30, 2007, the Bank had 76.8% of total assets in the loan portfolio and a loan to deposit ratio of 93.6%, as compared to 72.4% of total assets in the loan portfolio and a loan to deposit ratio of 85.1% at December 31, 2007. Liquid assets at September 30, 2007 include cash and cash equivalents totaling \$28.9 million as compared to \$43.1 million at December 31, 2006. Other sources of liquidity include collateralized and uncollateralized lines of credit from other banks, the Federal Home Loan Bank, and from the Federal Reserve Bank totaling \$407.6 million at September 30, 2007.

The liquidity of the parent company, United Security Bancshares, is primarily dependent on the payment of cash dividends by its subsidiary, United Security Bank, subject to limitations imposed by the Financial Code of the State of California. During the nine months ended September 30, 2007, dividends paid by the Bank to the parent company totaled \$14.9 million dollars.

#### *Cash Flow*

Cash and cash equivalents have declined during the two nine-month periods ended September 30, 2006 and 2007 with period-end balances as follows (*from Consolidated Statements of Cash Flows – in 000's*):

	Balance
December 31, 2005	\$ 63,030
September 30, 2006	\$ 39,420
December 31, 2006	\$ 43,068
September 30, 2007	\$ 28,881

Cash and cash equivalents decreased \$14.2 million during the nine months ended September 30, 2007, as compared to a decrease of \$23.6 million during the nine months ended September 30, 2006. During both nine-month periods presented, net cash used in investing activities, consisting primarily of loan funding, more than outweighed net cash provided from operations and financing activities. The Company has sought to increase cash provided by financing activities through increases in deposits, but with deposit growth slowing during 2007, the Company has placed greater reliance on borrowed funds and brokered time deposits to fulfill liquidity needs and provide cash flow to fund loan growth. Borrowed funds increased \$25.4 million between September 30, 2006 and September 30, 2007, while brokered time deposits increased \$61.1 million during the same period. Competition for deposits has increased over the past several years and deposit pricing may be a key issue in generating deposit growth in the future, which may potentially result in decreasing net interest margins. If deposit pricing becomes too competitive, the Company has the option of limiting loan growth or selling loans to mitigate liquidity concerns.

As shown in the *Consolidated Statements of Cash Flows*, net cash provided by operating activities totaled \$14.8 million during the nine months ended September 30, 2007 as compared to \$11.3 million for the same nine-month period of 2006, representing an increase of \$3.4 million or 30.2% between the two periods presented. Net cash used in investing activities totaling \$53.2 million during the nine months ended September 30, 2007 was comprised of net increases in loans of \$63.8 million, and purchases of investment securities totaling \$19.2 million. This was partially offset by maturities of investment securities and interesting-bearing deposits in other banks totaling \$24.6 million, as well as \$6.4 million in cash and equivalents received from the Legacy merger during February 2007. Net cash used in investing activities totaled \$73.1 million during the nine months ended September 30, 2006 and, as with 2007, consisted primarily of net loan growth of \$83.5 million which was only partially offset by other investing activities. Net cash provided by financing activities totaled \$24.2 million and \$38.2 million for the two nine-month periods ended September 30, 2007 and 2006, respectively. Cash provided by increases in deposit accounts totaled \$12.8 million and \$43.7 million for the nine-month periods ended September 30, 2007 and 2006, respectively. Financing activities were enhanced during the nine months ended September 30, 2007 with an increase of \$15.4 million in federal funds purchased, and an increase of \$10.0 million FHLB term borrowings. These were partially offset by other financing activities including repurchases of common stock totaling \$9.1 million and \$2.2 million at September 30, 2007 and 2006, respectively, as well as payments of dividends on common stock totaling \$4.4 million and \$3.6 million at September 30, 2007 and 2006, respectively.

**Regulatory Matters*****Capital Adequacy***

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

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

The following table sets forth the Company’s and the Bank’s actual capital positions at September 30, 2007 and the minimum capital requirements for both under the regulatory guidelines discussed above:

**Table 9. Capital Ratios**

	Company Actual Capital Ratios	Bank Actual Capital Ratios	Minimum Capital Ratios
Total risk-based capital ratio	12.10%	11.75%	10.00%
Tier 1 capital to risk-weighted assets	10.95%	10.60%	6.00%
Leverage ratio	10.84%	10.50%	5.00%

As is indicated by the above table, the Company and the Bank exceeded all applicable regulatory capital guidelines at September 30, 2007. Management believes that, under the current regulations, both will continue to meet their minimum capital requirements in the foreseeable future.

***Dividends***

The primary source of funds with which dividends will be paid to shareholders is from cash dividends received by the Company from the Bank. During the first nine months of 2007, the Company has received \$14.9 million in cash dividends from the Bank, from which the Company paid \$4.4 million in dividends to shareholders.

***Reserve Balances***

The Bank is required to maintain average reserve balances with the Federal Reserve Bank. At September 30, 2007 the Bank’s qualifying balance with the Federal Reserve was approximately \$25,000 consisting of balances held with the Federal Reserve.

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

#### ***Interest Rate Sensitivity and Market Risk***

There have been no material changes in the Company's quantitative and qualitative disclosures about market risk as of September 30, 2007 from those presented in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

As part of its overall risk management, the Company pursues various asset and liability management strategies, which may include obtaining derivative financial instruments to mitigate the impact of interest fluctuations on the Company's net interest margin. During the second quarter of 2003, the Company entered into an interest rate swap agreement with the purpose of minimizing interest rate fluctuations on its interest rate margin and equity.

Under the interest rate swap agreement, the Company receives a fixed rate and pays a variable rate based on a spread from the Prime Rate ("Prime"). The swap qualifies as a cash flow hedge under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended, and is designated as a hedge of the variability of cash flows the Company receives from certain variable-rate loans indexed to Prime. In accordance with SFAS No. 133, the swap agreement is measured at fair value and reported as an asset or liability on the consolidated balance sheet. The portion of the change in the fair value of the swap that is deemed effective in hedging the cash flows of the designated assets are recorded in accumulated other comprehensive income and reclassified into interest income when such cash flow occurs in the future. Any ineffectiveness resulting from the hedge is recorded as a gain or loss in the consolidated statement of income as part of noninterest income. The amortizing hedge has a remaining notional value of \$5.8 million at September 30, 2007, matures in September 2008, and has a duration of approximately 3 months. As of September 30, 2007, the maximum length of time over which the Company is hedging its exposure to the variability of future cash flows is approximately 1.25 years. As of September 30, 2007, the loss amounts in accumulated other comprehensive income associated with these cash flows totaled \$15,000 (net of tax benefit of \$10,000). During the nine months ended September 30, 2007, \$270,000 was reclassified from other accumulated other comprehensive income into expense, and is reflected as a reduction in interest income.

The Company performs a quarterly analysis of the interest rate swap agreement. At September 30, 2007, the Company determined that the swap remains highly effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedge, and therefore continues to qualify for hedge accounting under the guidelines of SFAS No. 133. However, during the second quarter of 2006, the Company determined that the underlying loans being hedged were paying off faster than the notional value of the hedge instrument was amortizing. This difference between the notional value of the hedge and the underlying hedged assets is considered an "overhedge" pursuant to SFAS No. 133 guidelines and may constitute ineffectiveness if the difference is other than temporary. The Company determined during 2006 that the difference was other than temporary and, as a result, reclassified a net total of \$75,000 of the pretax hedge loss reported in other comprehensive income into earnings during 2006. As of September 30, 2007, the notional value of the hedge is still in excess of the value of the underlying loans by approximately \$3.2 million, but has improved from the \$3.3 million difference reflected at December 31, 2006. As a result, the Company recorded a pretax hedge gain related to swap ineffectiveness of approximately \$44,000 during the first nine months of 2007. Amounts recognized as hedge ineffectiveness gains or losses are reflected in noninterest income.

The Board of Directors has adopted an interest rate risk policy which establishes maximum decreases in net interest income of 12% and 15% in the event of a 100 BP and 200 BP increase or decrease in market interest rates over a twelve month period. Based on the information and assumptions utilized in the simulation model at September 30, 2007, the resultant projected impact on net interest income falls within policy limits set by the Board of Directors for all rate scenarios run.

The Company's interest rate risk policy establishes maximum decreases in the Company's market value of equity of 12% and 15% in the event of an immediate and sustained 100 BP and 200 BP increase or decrease in market interest rates. As shown in the table below, the percentage changes in the net market value of the Company's equity are within policy limits for both rising and falling rate scenarios.

The following sets forth the analysis of the Company's market value risk inherent in its interest-sensitive financial instruments as they relate to the entire balance sheet at September 30, 2007 and December 31, 2006 (\$ in thousands). Fair value estimates are subjective in nature and involve uncertainties and significant judgment and, therefore, cannot be determined with absolute precision. Assumptions have been made as to the appropriate discount rates, prepayment speeds, expected cash flows and other variables. Changes in these assumptions significantly affect the estimates and as such, the obtained fair value may not be indicative of the value negotiated in the actual sale or liquidation of such financial instruments, nor comparable to that reported by other financial institutions. In addition, fair value estimates are based on existing financial instruments without attempting to estimate future business.

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Change in Rates	September 30, 2007			December 31, 2006		
	Estimated MV of Equity	Change in MV of Equity \$	Change in MV of Equity %	Estimated MV Of Equity	Change in MV of Equity \$	Change in MV of Equity %
+ 200 BP	\$ 112,813	\$ 5,299	3.68%	\$ 90,317	\$ 912	1.02%
+ 100 BP	111,261	3,747	2.76%	90,524	1,118	1.25%
0 BP	107,514	0	0.00%	89,406	0	0.00%
- 100 BP	101,998	(5,516)	-3.96%	87,291	(2,115)	-2.37%
- 200 BP	94,982	(12,532)	-9.19%	84,278	(5,128)	-5.74%

36

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

a) As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as defined in the Securities and Exchange Act Rule 13(a)-15(e). Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective on a timely manner to alert them to material information relating to the Company which is required to be included in the Company's periodic Securities and Exchange Commission filings.

(b) Changes in Internal Controls over Financial Reporting: During the quarter ended September 30, 2007, the Company did not make any significant changes in, nor take any corrective actions regarding, its internal controls over financial reporting or other factors that could significantly affect these controls.

The Company does not expect that its disclosure controls and procedures and internal control over financial reporting will prevent all error and fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns in controls or procedures can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.



**PART II. Other Information**

**Item 1.** Not applicable

**Item 1A.** There have been no material changes in the Company's risk factors during the second quarter of 2007.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds***Purchases of Equity Securities by Affiliates and Associated Purchasers*

Period	Total Number Of Shares Purchased	Weighted Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan or Program	Maximum Number of Shares That May Yet be Purchased Under the Plans or Programs
07/01/07 to 07/31/07	11,363	\$ 18.31	11,363	341,136
08/01/07 to 08/31/07	4,226	\$ 17.33	4,226	336,910
09/01/07 to 09/30/07	13,327	\$ 18.63	13,327	323,583
<b>Total third quarter 2007</b>	<b>28,916</b>	<b>\$ 18.32</b>	<b>28,916</b>	

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

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

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

During the nine months ended September 30, 2007, 453,077 shares were repurchased at a total cost of \$9.2 million and an average per share price of \$20.30. Of the shares repurchased during 2007, 166,660 shares were repurchased under the 2004 plan at an average cost of \$20.46 per shares, and 286,417 shares were repurchased under the 2007 plan at an average cost of \$20.05 per share.



**Item 3.** Not applicable

**Item 4.** Not applicable

**Item 5.** Not applicable

**Item 6.** Exhibits:

(a)

Exhibits:

- 11 Computation of Earnings per Share\*
- 31.1 Certification of the Chief Executive Officer of United Security Bancshares pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of the Chief Financial Officer of United Security Bancshares pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of the Chief Executive Officer of United Security Bancshares pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of the Chief Financial Officer of United Security Bancshares pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

\* Data required by Statement of Financial Accounting Standards No. 128, *Earnings per Share*, is provided in note 6 to the consolidated financial statements in this report.

**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 thereunto duly authorized.

United Security Bancshares

Date: November 8, 2007

/S/ Dennis R. Woods  
Dennis R. Woods  
President and  
Chief Executive Officer

/S/ Kenneth L. Donahue  
Kenneth L. Donahue  
Senior Vice President and  
Chief Financial Officer