

PLUMAS BANCORP  
Form 10-Q  
May 02, 2019

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark  
One)

**QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE  
ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED March 31, 2019**

**TRANSITION REPORT UNDER SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE  
ACT OF 1934  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_**

**COMMISSION FILE NUMBER: 000-49883**

**PLUMAS BANCORP**

(Exact Name of Registrant as Specified in Its Charter)

**California** **75-2987096**  
(State or Other Jurisdiction of Incorporation or Organization) (I.R.S. Employer Identification No.)

**35 S. Lindan Avenue, Quincy, California** **95971**  
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code **(530) 283-7305**

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large Accelerated Filer      Accelerated Filer      Non-Accelerated Filer      Smaller Reporting Company      Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

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

| <u>Title of Each Class:</u> | <u>Trading Symbol</u> | <u>Name of Each Exchange on which Registered:</u> |
|-----------------------------|-----------------------|---|
| Common Stock, no par value  | PLBC                  | The NASDAQ Stock Market LLC                       |

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of April 26, 2019.  
5,153,560 shares.

**PART I – FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****PLUMAS BANCORP AND SUBSIDIARY****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)**

(In thousands, except share data)

|   | <b>March<br/>31,<br/>2019</b> | <b>December<br/>31,<br/>2018</b> |
|---|-------------------------------|----------------------------------|
| <b><u>Assets</u></b>  |                               |                                  |
| Cash and cash equivalents   | \$44,753                      | \$ 46,686                        |
| Investment securities available for sale  | 173,227                       | 171,507                          |
| Loans, less allowance for loan losses of \$7,067 at March 31, 2019 and \$6,958 at December 31, 2018 | 569,778                       | 562,498                          |
| Real estate acquired through foreclosure  | 1,170                         | 1,170                            |
| Premises and equipment, net   | 14,224                        | 14,287                           |
| Bank owned life insurance   | 12,938                        | 12,856                           |
| Accrued interest receivable and other assets  | 15,287                        | 15,394                           |
| Total assets  | \$831,377                     | \$ 824,398                       |
| <b><u>Liabilities and Shareholders' Equity</u></b>  |                               |                                  |
| Deposits:   |                               |                                  |
| Non-interest bearing  | \$312,121                     | \$ 304,039                       |
| Interest bearing  | 418,802                       | 422,526                          |
| Total deposits  | 730,923                       | 726,565                          |
| Repurchase agreements   | 8,910                         | 13,058                           |
| Accrued interest payable and other liabilities  | 8,527                         | 7,533                            |
| Junior subordinated deferrable interest debentures  | 10,310                        | 10,310                           |
| Total liabilities   | 758,670                       | 757,466                          |
| Commitments and contingencies (Note 5)  |                               |                                  |
| Shareholders' equity:   | 7,070                         | 6,944                            |

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Common stock, no par value; 22,500,000 shares authorized; issued and outstanding –  
5,150,876 shares at March 31, 2019 and 5,137,476 at December 31, 2018

|  |           |            |
|--|-----------|------------|
| Retained earnings                          | 65,823    | 62,005     |
| Accumulated other comprehensive loss, net  | (186 )    | (2,017 )   |
| Total shareholders' equity                 | 72,707    | 66,932     |
| Total liabilities and shareholders' equity | \$831,377 | \$ 824,398 |

See notes to unaudited condensed consolidated financial statements.

**PLUMAS BANCORP AND SUBSIDIARY****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

(In thousands, except per share data)

|   | <b>For the Three<br/>Months<br/>Ended March<br/>31,<br/>2019    2018</b> |         |
|---|--|---------|
| <b>Interest Income:</b>   |  |         |
| Interest and fees on loans  | \$8,510  | \$6,777 |
| Interest on investment securities                                 | 1,137  | 856     |
| Other   | 179  | 185     |
| Total interest income   | 9,826  | 7,818   |
| <b>Interest Expense:</b>  |  |         |
| Interest on deposits  | 297  | 151     |
| Interest on junior subordinated deferrable interest debentures    | 140  | 112     |
| Other   | 3  | 2       |
| Total interest expense  | 440  | 265     |
| Net interest income before provision for loan losses              | 9,386  | 7,553   |
| <b>Provision for Loan Losses</b>                                  | 400  | 200     |
| Net interest income after provision for loan losses               | 8,986  | 7,353   |
| <b>Non-Interest Income:</b>                                       |  |         |
| Service charges   | 650  | 640     |
| Interchange revenue   | 513  | 491     |
| Gain on sale of loans   | 244  | 666     |
| Gain on equity securities with no readily determinable fair value | -  | 209     |
| Loss on sale of investments                                       | -  | (8 )    |
| Other   | 558  | 533     |
| Total non-interest income   | 1,965  | 2,531   |
| <b>Non-Interest Expenses:</b>                                     |  |         |
| Salaries and employee benefits                                    | 3,200  | 3,113   |
| Occupancy and equipment   | 858  | 702     |
| Other   | 1,626  | 1,634   |
| Total non-interest expenses                                       | 5,684  | 5,449   |
| Income before provision for income taxes                          | 5,267  | 4,435   |
| <b>Provision for Income Taxes</b>                                 | 1,449  | 1,155   |
| Net income  | \$3,818  | \$3,280 |
| Basic earnings per common share                                   | \$0.74   | \$0.65  |
| Diluted earnings per common share                                 | \$0.73   | \$0.63  |

See notes to unaudited condensed consolidated financial statements.

2

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**PLUMAS BANCORP AND SUBSIDIARY****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Unaudited)**

(In thousands)

|  | <b>For the Three<br/>Months<br/>Ended March<br/>31,<br/>2019    2018</b> |         |
|--|--|---------|
| Net income   | \$3,818  | \$3,280 |
| Other comprehensive income:  |  |         |
| Change in net unrealized gain/loss                                 | 2,599  | (2,589) |
| Reclassification adjustments for net losses included in net income | -  | 8       |
| Net unrealized holding gain (loss)                                 | 2,599  | (2,581) |
| Related tax effect:  |  |         |
| Change in net unrealized gain/loss                                 | (768 )   | 765     |
| Reclassification of net losses included in net income              | -  | (2 )    |
| Income tax effect  | (768 )   | 763     |
| Other comprehensive income (loss)                                  | 1,831  | (1,818) |
| Total comprehensive income   | \$5,649  | \$1,462 |

See notes to unaudited condensed consolidated financial statements.

**PLUMAS BANCORP AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

(in thousands, except shares)

|  | <b>Common Stock</b> |               | <b>Retained</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>(Loss) Income<br/>(Net of Taxes)</b> | <b>Total<br/>Shareholders'<br/>Equity</b> |
|--|---------------------|---------------|-----------------|---|---|
|  | <b>Shares</b>       | <b>Amount</b> | <b>Earnings</b> |   |   |
| Balance, December 31, 2017               | 5,064,972           | \$ 6,415      | \$ 49,855       | \$ (570   | ) \$ 55,700                               |
| Net Income                               |                     |               | 3,280           |   | 3,280                                     |
| Other comprehensive loss                 |                     |               |                 | (1,818  | ) (1,818                                  |
| Exercise of stock options and tax effect | 17,704              | 82            |                 |   | 82  |
| Stock-based compensation expense         |                     | 47            |                 |   | 47  |
| Balance, March 31, 2018                  | 5,082,676           | \$ 6,544      | \$ 53,135       | \$ (2,388   | ) \$ 57,291                               |
| Balance, December 31, 2018               | 5,137,476           | \$ 6,944      | \$ 62,005       | \$ (2,017   | ) \$ 66,932                               |
| Net Income                               |                     |               | 3,818           |   | 3,818                                     |
| Other comprehensive income               |                     |               |                 | 1,831   | 1,831                                     |
| Exercise of stock options and tax effect | 13,400              | 76            |                 |   | 76  |
| Stock-based compensation expense         |                     | 50            |                 |   | 50  |
| Balance, March 31, 2019                  | 5,150,876           | \$ 7,070      | \$ 65,823       | \$ (186   | ) \$ 72,707                               |

See notes to unaudited condensed consolidated financial statements.



**PLUMAS BANCORP AND SUBSIDIARY****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

(In thousands)

|  | <b>For the Three<br/>Months<br/>Ended March 31,<br/>2019      2018</b> |          |
|--|--|----------|
| <b>Cash Flows from Operating Activities:</b>   |  |          |
| Net income   | \$3,818  | \$3,280  |
| Adjustments to reconcile net income to net cash provided by operating activities:                          |  |          |
| Provision for loan losses  | 400  | 200      |
| Change in deferred loan origination costs/fees, net  | (266 )   | (315 )   |
| Depreciation and amortization  | 355  | 245      |
| Stock-based compensation expense   | 50   | 47       |
| Loss on sale of investments  | -  | 8        |
| Amortization of investment security premiums   | 180  | 169      |
| Gain on equity securities with no readily determinable fair value  | -  | (209 )   |
| Gain on sale of OREO and other vehicles  | (9 )   | (34 )    |
| Gain on sale of loans held for sale  | (244 )   | (666 )   |
| Loans originated for sale  | (3,711)  | (12,612) |
| Proceeds from loan sales   | 6,048  | 11,939   |
| Earnings on bank-owned life insurance  | (82 )  | (83 )    |
| Increase in accrued interest receivable and other assets   | (627 )   | (99 )    |
| Increase in accrued interest payable and other liabilities   | 994  | 1,023    |
| Net cash provided by operating activities  | 6,906  | 2,893    |
| <b>Cash Flows from Investing Activities:</b>   |  |          |
| Proceeds from principal repayments from available-for-sale government-sponsored mortgage-backed securities | 4,211  | 3,159    |
| Purchases of available-for-sale securities   | (3,500)  | (20,788) |
| Proceeds from sale of available-for-sale securities  | -  | 4,157    |
| Net increase in loans  | (9,801)  | (1,896 ) |
| Proceeds from Bank owned life insurance  | -  | 338      |
| Proceeds from sale of OREO   | -  | 412      |
| Proceeds from sale of other vehicles   | 167  | 112      |
| Purchase of premises and equipment   | (202 )   | (51 )    |
| Net cash used in investing activities  | (9,125)  | (14,557) |

Continued on next page.



**PLUMAS BANCORP AND SUBSIDIARY****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

(In thousands)

(Continued)

|  | <b>For the Three<br/>Months<br/>Ended March 31,<br/>2019      2018</b> |                 |
|--|--|-----------------|
| <b>Cash Flows from Financing Activities:</b>                             |  |                 |
| Net increase (decrease) in demand, interest bearing and savings deposits | \$6,707  | \$(6,263 )      |
| Net decrease in time deposits  | (2,349 )   | (3,603 )        |
| Net decrease in securities sold under agreements to repurchase           | (4,148 )   | (1,399 )        |
| Proceeds from exercise of stock options                                  | 76   | 82              |
| Net cash provided by (used in) financing activities                      | 286  | (11,183)        |
| Decrease in cash and cash equivalents                                    | (1,933 )   | (22,847)        |
| <b>Cash and Cash Equivalents at Beginning of Year</b>                    | <b>46,686</b>  | <b>87,537</b>   |
| <b>Cash and Cash Equivalents at End of Period</b>                        | <b>\$44,753</b>  | <b>\$64,690</b> |
| <b>Supplemental Disclosure of Cash Flow Information:</b>                 |  |                 |
| Cash paid during the period for:   |  |                 |
| Interest expense   | \$434  | \$264           |
| Income taxes   | \$-  | \$-             |
| <b>Non-Cash Investing Activities:</b>                                    |  |                 |
| Real estate and vehicles acquired through foreclosure                    | \$189  | \$220           |

See notes to unaudited condensed consolidated financial statements.

## **PLUMAS BANCORP AND SUBSIDIARY**

### **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

#### **1. THE BUSINESS OF PLUMAS BANCORP**

During 2002, Plumas Bancorp (the "Company") was incorporated as a bank holding company for the purpose of acquiring Plumas Bank (the "Bank") in a one bank holding company reorganization. This corporate structure gives the Company and the Bank greater flexibility in terms of operation, expansion and diversification. The Company formed Plumas Statutory Trust I ("Trust I") for the sole purpose of issuing trust preferred securities on September 26, 2002. The Company formed Plumas Statutory Trust II ("Trust II") for the sole purpose of issuing trust preferred securities on September 28, 2005.

The Bank operates eleven branches in California, including branches in Alturas, Chester, Fall River Mills, Greenville, Kings Beach, Portola, Quincy, Redding, Susanville, Tahoe City, and Truckee. In December 2015 the Bank opened a branch in Reno, Nevada; its first branch outside of California and in 2018 the Bank purchased a branch located in Carson City, Nevada. The Bank's administrative headquarters is in Quincy, California. In addition, the Bank operates a lending office specializing in government-guaranteed lending in Auburn, California, and commercial/agricultural lending offices in Chico and Red Bluff, California and Klamath Falls, Oregon. The Bank's primary source of revenue is generated from providing loans to customers who are predominately small and middle market businesses and individuals residing in the surrounding areas.

#### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

##### Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of the Company and the consolidated accounts of its wholly-owned subsidiary, Plumas Bank. All significant intercompany balances and transactions have been eliminated.

Plumas Statutory Trust I and Trust II are not consolidated into the Company's consolidated financial statements and, accordingly, are accounted for under the equity method. The Company's investment in Trust I of \$341,000 and Trust II of \$175,000 are included in accrued interest receivable and other assets on the consolidated balance sheet. The junior subordinated deferrable interest debentures issued and guaranteed by the Company and held by Trust I and Trust II are reflected as debt on the consolidated balance sheet.

The accounting and reporting policies of Plumas Bancorp and subsidiary conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

The unaudited condensed consolidated financial statements of the Company have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") for interim reporting on Form 10-Q. Accordingly, certain disclosures normally presented in the notes to the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been omitted. The Company believes that the disclosures are adequate to make the information not misleading. These interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2018 Annual Report to Shareholders on Form 10-K. The results of operations for the three-month period ended March 31, 2019 may not necessarily be indicative of future operating results. In preparing such financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the periods reported. Actual results could differ significantly from those estimates.

#### Reclassifications

Certain reclassifications have been made to prior years' balances to conform to the classifications used in 2019. These reclassifications had no impact on the Company's consolidated financial position, results of operations or net change in cash and cash equivalents.

### Segment Information

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

### Revenue from Contracts with Customers

The Company records revenue from contracts with customers in accordance with Accounting Standards Codification Topic 606, "Revenue from Contracts with Customers" ("Topic 606"). Under Topic 606, the Company must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the Company satisfies a performance obligation. Significant revenue has not been recognized in the current reporting period that results from performance obligations satisfied in previous periods.

Most of the Company's revenue-generating transactions are not subject to ASC 606, including revenue generated from financial instruments, such as the Company's loans and investment securities. The Company has evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Condensed Consolidated Statements of Income was not necessary. The Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, there is little judgment involved in applying Topic 606 that significantly affects the determination of the amount and timing of revenue from contracts with customers.

### Recently Adopted Accounting Pronouncements

On February 25, 2016, the FASB issued ASU 2016-02, Leases. The most significant change for lessees is the requirement under the new guidance to recognize right-of-use assets and lease liabilities for all leases not considered short-term leases, which is generally defined as a lease term of less than 12 months. This change results in lessees recognizing right-of-use assets and lease liabilities for most leases currently accounted for as operating leases under prior lease accounting guidance. ASU 2016-02 is effective for interim and annual periods beginning after December 15, 2018. The Company has several lease agreements, including two branch locations, which are currently considered operating leases, and therefore, not recognized on the Company's consolidated statements of condition. The Company

adopted ASU No. 2016-02 on January 1, 2019 and recorded \$565,000 in right-of-use assets and lease liabilities on adoption.

In July 2018, the FASB issued ASU No. 2018-11, Leases - Targeted Improvements. ASU No. 2018-11 provides entities with relief from the costs of implementing certain aspects of the new leasing standard, ASU No. 2016-02. Specifically, under the amendments in ASU 2018-11: (1) entities may elect not to recast the comparative periods presented when transitioning to the new leasing standard, and (2) lessors may elect not to separate lease and non-lease components when certain conditions are met. The amendments have the same effective date as ASU 2016-02 (January 1, 2019 for the Company). The Company adopted ASU No. 2018-11 on January 1, 2019. The provisions of ASU 2018-11 did not have a material impact on the Company's Consolidated Financial Statements.

On March 30, 2017, the FASB issued ASU 2017-08, Receivables – Non-Refundable Fees and Other Costs: Premium Amortization on Purchased Callable Debt Securities. This ASU amends the amortization period for certain purchased callable debt securities held at a premium, shortening such period to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. ASU 2017-08 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). The Company adopted ASU No. 2017-08 on January 1, 2019. The provisions of ASU No. 2017-08 did not have a material impact on the Company's Consolidated Financial Statements.

Pending Accounting Pronouncements

In June 2016, the FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments. ASU No. 2016-13 significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. The standard will replace today's "incurred loss" approach with an "expected loss" model. The new model, referred to as the current expected credit loss ("CECL") model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for-sale ("AFS") debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. The ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. ASU No. 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the allowance for loan and lease losses. ASU No. 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted for interim and annual reporting periods beginning after December 15, 2018. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). The Company has begun its implementation efforts by establishing an implementation team chaired by the Company's Chief Lending Officer and composed of members of the Company's credit administration and accounting departments. We have purchased software to support the CECL calculation of the allowance for loan losses under ASU No 2016-13 and have engaged the software vendor to assist in the transition to the CECL model. We expect to produce an initial CECL allowance calculation prior to June 30, 2019. The Company's preliminary evaluation indicates the provisions of ASU No. 2016-13 are expected to impact the Company's Consolidated Financial Statements, in particular the level of the reserve for credit losses. However, the Company continues to evaluate the extent of the potential impact.

In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement, Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement. The amendments in this update modify the disclosure requirements for fair value measurements by removing, modifying, or adding certain disclosures. The update is effective for interim and annual periods in fiscal years beginning after December 15, 2019, with early adoption permitted. Entities are also allowed to elect early adoption of the eliminated or modified disclosure requirements and delay adoption of the new disclosure requirements until their effective date. As ASU No. 2018-13 only revises disclosure requirements, it will not have a material impact on the Company's Consolidated Financial Statements.



### 3. INVESTMENT SECURITIES AVAILABLE FOR SALE

The amortized cost and estimated fair value of investment securities at March 31, 2019 and December 31, 2018 consisted of the following, in thousands:

| <u>Available-for-Sale</u>  | March 31, 2019    |                              |                               |               |
|--|-------------------|------------------------------|-------------------------------|---------------|
|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| Debt securities:   |                   |                              |                               |               |
| U.S. Government-sponsored agencies collateralized by mortgage obligations- residential | \$132,756         | \$ 652                       | \$ (1,320 )                   | \$132,088     |
| Obligations of states and political subdivisions                                       | 40,735            | 554                          | (150 )                        | 41,139        |
|  | \$173,491         | \$ 1,206                     | \$ (1,470 )                   | \$173,227     |

Net unrealized loss on available-for-sale investment securities totaling \$264,000 were recorded, net of \$78,000 in tax benefits, as accumulated other comprehensive income within shareholders' equity at March 31, 2019. No investment securities were sold during the three months ended March 31, 2019.

| <u>Available-for-Sale</u>  | December 31, 2018 |                              |                               |               |
|--|-------------------|------------------------------|-------------------------------|---------------|
|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| Debt securities:   |                   |                              |                               |               |
| U.S. Government-sponsored agencies collateralized by mortgage obligations- residential | \$135,059         | \$ 240                       | \$ (2,621 )                   | \$132,678     |
| Obligations of states and political subdivisions                                       | 39,311            | 121                          | (603 )                        | 38,829        |
|  | \$174,370         | \$ 361                       | \$ (3,224 )                   | \$171,507     |

Unrealized loss on available-for-sale investment securities totaling \$2,863,000 were recorded, net of \$846,000 in tax benefits, as accumulated other comprehensive loss within shareholders' equity at December 31, 2018. During the three months ended March 31, 2018 the Company sold eighteen available-for-sale investment securities for total proceeds of \$4,157,000 recording a \$8,000 loss on sale. The Company realized a gain on sale from eight of these securities totaling \$4,000 and a loss on sale on ten securities of \$12,000.

There were no transfers of available-for-sale investment securities during the three months ended March 31, 2019 and twelve months ended December 31, 2018. There were no securities classified as held-to-maturity at March 31, 2019 or

December 31, 2018.

10

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Investment securities with unrealized losses at March 31, 2019 and December 31, 2018 are summarized and classified according to the duration of the loss period as follows, in thousands:

| <u>March 31, 2019</u>   | Less than 12 Months |                   | 12 Months or More |                   | Total      |                   |
|---|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
|   | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value | Unrealized Losses |
| Debt securities:  |                     |                   |                   |                   |            |                   |
| U.S. Government-sponsored agencies collateralized by mortgage obligations-residential | \$-                 | \$ -              | \$84,580          | \$ 1,320          | \$84,580   | \$ 1,320          |
| Obligations of states and political subdivisions                                      | 681                 | 10                | 10,538            | 140               | 11,219     | 150               |
|   | \$681               | \$ 10             | \$95,118          | \$ 1,460          | \$95,799   | \$ 1,470          |

| <u>December 31, 2018</u>  | Less than 12 Months |                   | 12 Months or More |                   | Total      |                   |
|---|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
|   | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value | Unrealized Losses |
| Debt securities:  |                     |                   |                   |                   |            |                   |
| U.S. Government-sponsored agencies collateralized by mortgage obligations-residential | \$26,478            | \$ 269            | \$77,476          | \$ 2,352          | \$103,954  | \$ 2,621          |
| Obligations of states and political subdivisions                                      | 19,270              | 284               | 5,672             | 319               | 24,942     | 603               |
|   | \$45,748            | \$ 553            | \$83,148          | \$ 2,671          | \$128,896  | \$ 3,224          |

At March 31, 2019, the Company held 219 securities of which 107 were in a loss position. Of the securities in a loss position, 1 was in a loss position for less than twelve months. Of the 219 securities, 97 are U.S. Government-sponsored agencies collateralized by residential mortgage obligations and 122 were obligations of states and political subdivisions. The unrealized losses relate principally to market rate conditions. All of the securities continue to pay as scheduled. When analyzing an issuer's financial condition, management considers the length of time and extent to which the market value has been less than cost; the historical and implied volatility of the security; the financial condition of the issuer of the security; and the Company's intent and ability to hold the security to recovery. As of March 31, 2019, management does not have the intent to sell these securities nor does it believe it is more likely than not that it will be required to sell these securities before the recovery of its amortized cost basis. Based on the Company's evaluation of the above and other relevant factors, the Company does not believe the securities that are in an unrealized loss position as of March 31, 2019 are other than temporarily impaired.

The amortized cost and estimated fair value of investment securities at March 31, 2019 by contractual maturity are shown below, in thousands.

| Amortized Cost | Estimated Fair |
|----------------|----------------|
|----------------|----------------|

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|  |            | Value      |
|--|------------|------------|
| Within one year  | \$ -       | \$ -       |
| After one year through five years                        | 6,428      | 6,504      |
| After five years through ten years                       | 14,600     | 14,718     |
| After ten years  | 19,707     | 19,917     |
| Investment securities not due at a single maturity date: |            |            |
| Government-sponsored mortgage-backed securities          | 132,756    | 132,088    |
|  | \$ 173,491 | \$ 173,227 |

Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

Investment securities with amortized costs totaling \$89,081,000 and \$92,166,000 and estimated fair values totaling \$88,234,000 and \$90,122,000 at March 31, 2019 and December 31, 2018, respectively, were pledged to secure deposits and repurchase agreements.

**4. LOANS AND THE ALLOWANCE FOR LOAN LOSSES**

Outstanding loans are summarized below, in thousands:

|   | March<br>31,<br>2019 | December<br>31,<br>2018 |
|---|----------------------|-------------------------|
| Commercial                                      | \$42,707             | \$49,563                |
| Agricultural                                    | 70,041               | 69,160                  |
| Real estate – residential                       | 16,413               | 15,900                  |
| Real estate – commercial                        | 282,533              | 271,710                 |
| Real estate – construction and land development | 37,637               | 40,161                  |
| Equity lines of credit                          | 37,519               | 38,490                  |
| Auto  | 82,737               | 77,135                  |
| Other   | 3,859                | 4,080                   |
| Total loans                                     | 573,446              | 566,199                 |
| Deferred loan costs, net                        | 3,399                | 3,257                   |
| Allowance for loan losses                       | (7,067 )             | (6,958 )                |
| Total net loans                                 | \$569,778            | \$562,498               |

Changes in the allowance for loan losses, in thousands, were as follows:

|                                 | March<br>31,<br>2019 | December<br>31,<br>2018 |
|---------------------------------|----------------------|-------------------------|
| Balance, beginning of period    | \$6,958              | \$ 6,669                |
| Provision charged to operations | 400                  | 1,000                   |
| Losses charged to allowance     | (351 )               | (1,191 )                |
| Recoveries                      | 60                   | 480                     |
| Balance, end of period          | \$7,067              | \$ 6,958                |

The recorded investment in impaired loans totaled \$1,738,000 and \$1,275,000 at March 31, 2019 and December 31, 2018, respectively. The Company had specific allowances for loan losses of \$229,000 on impaired loans of \$897,000 at March 31, 2019 as compared to specific allowances for loan losses of \$181,000 on impaired loans of \$424,000 at December 31, 2018. The balance of impaired loans in which no specific reserves were required totaled \$841,000 and \$851,000 at March 31, 2019 and December 31, 2018, respectively. The average recorded investment in impaired loans for the three months ended March 31, 2019 and March 31, 2018 was \$1,352,000 and \$2,002,000, respectively. The

Company recognized \$18,000 in interest income for impaired loans during the three months ended March 31, 2019 and 2018. No interest was recognized on nonaccrual loans accounted for on a cash basis during the three months ended March 31, 2019 and 2018.

Included in impaired loans are troubled debt restructurings. A troubled debt restructuring is a formal restructure of a loan where the Company for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower. The concessions may be granted in various forms to include one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company's internal underwriting policy.

The carrying value of troubled debt restructurings at March 31, 2019 and December 31, 2018 was \$1,071,000 and \$1,080,000, respectively. The Company has allocated \$53,000 of specific reserves on loans to customers whose loan terms have been modified in troubled debt restructurings as of March 31, 2019 and December 31, 2018. The Company has not committed to lend additional amounts on loans classified as troubled debt restructurings at March 31, 2019 and December 31, 2018.

There were no troubled debt restructurings that occurred during the three months ending March 31, 2019 or March 31, 2018.

There were no troubled debt restructurings for which there was a payment default within twelve months following the modification during the three months ended March 31, 2019 and 2018, respectively.

At March 31, 2019 and December 31, 2018, nonaccrual loans totaled \$1,457,000 and \$1,117,000, respectively. Interest foregone on nonaccrual loans totaled \$26,000 and \$15,000 for the three months ended March 31, 2019 and 2018, respectively. There were no loans past due 90 days or more and on accrual status at March 31, 2019 and December 31, 2018.

Salaries and employee benefits totaling \$598,000 and \$498,000 have been deferred as loan origination costs during the three months ended March 31, 2019 and 2018, respectively.

The Company assigns a risk rating to all loans and periodically, but not less than annually, performs detailed reviews of all criticized and classified loans over \$100,000 to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Company and the Company's regulators. During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan.

The risk ratings can be grouped into three major categories, defined as follows:

**Special Mention** – Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

**Substandard** – A substandard loan is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well defined weaknesses include a project's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time or the project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

**Doubtful** – Loans classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass-rated loans.



The following table shows the loan portfolio allocated by management's internal risk ratings at the dates indicated, in thousands:

**March 31, 2019 Commercial Credit Exposure**

**Credit Risk Profile by Internally Assigned Grade**

| Grade:          | Commercial |           | Agricultural | Estate-<br>Residential | Estate-<br>Commercial | Estate-<br>Construction | Equity<br>LOC | Total |
|-----------------|------------|-----------|--------------|------------------------|-----------------------|-------------------------|---------------|-------|
|                 | Pass       | \$42,011  | \$ 69,791    | \$ 16,144              | \$ 278,359            | \$ 37,547               | \$37,341      |       |
| Special Mention | 540        | 250       | 120          | 3,564                  | -                     | -                       | 4,474         |       |
| Substandard     | 156        | -         | 149          | 610                    | 90                    | 178                     | 1,183         |       |
| Doubtful        | -          | -         | -            | -                      | -                     | -                       | -             |       |
| Total           | \$42,707   | \$ 70,041 | \$ 16,413    | \$ 282,533             | \$ 37,637             | \$37,519                | \$486,850     |       |

**December 31, 2018 Commercial Credit Exposure**

**Credit Risk Profile by Internally Assigned Grade**

| Grade:          | Commercial |           | Agricultural | Estate-<br>Residential | Estate-<br>Commercial | Estate-<br>Construction | Equity<br>LOC | Total |
|-----------------|------------|-----------|--------------|------------------------|-----------------------|-------------------------|---------------|-------|
|                 | Pass       | \$48,905  | \$ 68,910    | \$ 15,621              | \$ 268,159            | \$ 40,069               | \$38,304      |       |
| Special Mention | 481        | 250       | 124          | 3,420                  | -                     | -                       | 4,275         |       |
| Substandard     | 177        | -         | 155          | 131                    | 92                    | 186                     | 741           |       |
| Doubtful        | -          | -         | -            | -                      | -                     | -                       | -             |       |
| Total           | \$49,563   | \$ 69,160 | \$ 15,900    | \$ 271,710             | \$ 40,161             | \$38,490                | \$484,984     |       |

**Consumer Credit  
Exposure  
Credit Risk Profile**

**Based on Payment  
Activity  
March 31, 2019**

Auto Other Total

**Consumer Credit  
Exposure  
Credit Risk Profile**

**Based on Payment  
Activity  
December 31, 2018**

Auto Other Total

|            |          |         |          |          |         |          |
|------------|----------|---------|----------|----------|---------|----------|
| Grade:     |          |         |          |          |         |          |
| Performing | \$82,430 | \$3,859 | \$86,289 | \$76,734 | \$4,071 | \$80,805 |

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|                |          |         |          |          |         |          |
|----------------|----------|---------|----------|----------|---------|----------|
| Non-performing | 307      | -       | 307      | 401      | 9       | 410      |
| Total          | \$82,737 | \$3,859 | \$86,596 | \$77,135 | \$4,080 | \$81,215 |

14

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The following tables show the allocation of the allowance for loan losses at the dates indicated, in thousands:

|   | Commercial | Agricultural | Real Estate-Residential | Real Estate-Commercial | Real Estate-Construction | Equity LOC | Auto     | Other  | Total    |
|---|------------|--------------|-------------------------|------------------------|--------------------------|------------|----------|--------|----------|
| <b>Three months ended March 31, 2019:</b> |            |              |                         |                        |                          |            |          |        |          |
| <u>Allowance for Loan Losses</u>          |            |              |                         |                        |                          |            |          |        |          |
| Beginning balance                         | \$ 914     | \$ 538       | \$ 214                  | \$ 2,686               | \$ 758                   | \$ 464     | \$ 1,289 | \$ 95  | \$ 6,958 |
| Charge-offs                               | (16 )      | -            | -                       | -                      | -                        | -          | (312 )   | (23 )  | (351 )   |
| Recoveries                                | 9          | -            | 1                       | -                      | -                        | 1          | 47       | 2      | 60       |
| Provision                                 | (111 )     | 4            | (20 )                   | 283                    | (117 )                   | (15 )      | 360      | 16     | 400      |
| Ending balance                            | \$ 796     | \$ 542       | \$ 195                  | \$ 2,969               | \$ 641                   | \$ 450     | \$ 1,384 | \$ 90  | \$ 7,067 |
| <b>Three months ended March 31, 2018:</b> |            |              |                         |                        |                          |            |          |        |          |
| <u>Allowance for Loan Losses</u>          |            |              |                         |                        |                          |            |          |        |          |
| Beginning balance                         | \$ 725     | \$ 623       | \$ 231                  | \$ 2,729               | \$ 783                   | \$ 533     | \$ 946   | \$ 99  | \$ 6,669 |
| Charge-offs                               | (265 )     | -            | -                       | -                      | -                        | -          | (165 )   | (19 )  | (449 )   |
| Recoveries                                | 7          | -            | 91                      | 17                     | 2                        | 1          | 82       | 2      | 202      |
| Provision                                 | 305        | (129 )       | (110 )                  | 13                     | 6                        | (24 )      | 114      | 25     | 200      |
| Ending balance                            | \$ 772     | \$ 494       | \$ 212                  | \$ 2,759               | \$ 791                   | \$ 510     | \$ 977   | \$ 107 | \$ 6,622 |
| <b>March 31, 2019:</b>                    |            |              |                         |                        |                          |            |          |        |          |
| <u>Allowance for Loan Losses</u>          |            |              |                         |                        |                          |            |          |        |          |
| Ending balance:                           |            |              |                         |                        |                          |            |          |        |          |
| individually evaluated for impairment     | \$ 123     | \$ -         | \$ 35                   | \$ 61                  | \$ 10                    | \$ -       | \$ -     | \$ -   | \$ 229   |
| Ending balance:                           |            |              |                         |                        |                          |            |          |        |          |
| collectively evaluated for impairment     | 673        | 542          | 160                     | 2,908                  | 631                      | 450        | 1,384    | 90     | 6,838    |
| Ending balance                            | \$ 796     | \$ 542       | \$ 195                  | \$ 2,969               | \$ 641                   | \$ 450     | \$ 1,384 | \$ 90  | \$ 7,067 |
| <u>Loans</u>                              |            |              |                         |                        |                          |            |          |        |          |
| Ending balance:                           |            |              |                         |                        |                          |            |          |        |          |
| individually evaluated for impairment     | 123        | 250          | 639                     | 611                    | 115                      | -          | -        | -      | 1,738    |

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|                                       |           |           |           |            |           |           |           |          |            |
|---------------------------------------|-----------|-----------|-----------|------------|-----------|-----------|-----------|----------|------------|
| Ending balance:                       |           |           |           |            |           |           |           |          |            |
| collectively evaluated for impairment | \$ 42,584 | \$ 69,791 | \$ 15,774 | \$ 281,922 | \$ 37,522 | \$ 37,519 | \$ 82,737 | \$ 3,859 | \$ 571,708 |
| Ending balance                        | \$ 42,707 | \$ 70,041 | \$ 16,413 | \$ 282,533 | \$ 37,637 | \$ 37,519 | \$ 82,737 | \$ 3,859 | \$ 573,446 |
| <b><u>December 31,</u></b>            |           |           |           |            |           |           |           |          |            |
| <b><u>2018:</u></b>                   |           |           |           |            |           |           |           |          |            |
| <b><u>Allowance for</u></b>           |           |           |           |            |           |           |           |          |            |
| <b><u>Loan Losses</u></b>             |           |           |           |            |           |           |           |          |            |
| Ending balance:                       |           |           |           |            |           |           |           |          |            |
| individually evaluated for impairment | \$ 128    | \$ -      | 41        | \$ -       | \$ 12     | \$ -      | \$ -      | \$ -     | \$ 181     |
| Ending balance:                       |           |           |           |            |           |           |           |          |            |
| collectively evaluated for impairment | \$ 786    | \$ 538    | \$ 173    | \$ 2,686   | \$ 746    | \$ 464    | \$ 1,289  | \$ 95    | \$ 6,777   |
| Ending Balance                        | \$ 914    | \$ 538    | \$ 214    | \$ 2,686   | \$ 758    | \$ 464    | \$ 1,289  | \$ 95    | \$ 6,958   |
| <b><u>Loans</u></b>                   |           |           |           |            |           |           |           |          |            |
| Ending balance:                       |           |           |           |            |           |           |           |          |            |
| individually evaluated for impairment | \$ 128    | \$ 250    | \$ 649    | \$ 131     | \$ 117    | \$ -      | \$ -      | \$ -     | \$ 1,275   |
| Ending balance:                       |           |           |           |            |           |           |           |          |            |
| collectively evaluated for impairment | 49,435    | 68,910    | 15,251    | 271,579    | 40,044    | 38,490    | 77,135    | 4,080    | 564,924    |
| Ending balance                        | \$ 49,563 | \$ 69,160 | \$ 15,900 | \$ 271,710 | \$ 40,161 | \$ 38,490 | \$ 77,135 | \$ 4,080 | \$ 566,199 |

The following table shows an aging analysis of the loan portfolio by the time past due, in thousands:

| <b><u>March 31, 2019</u></b>      | 30-89<br>Days<br>Past<br>Due | 90 Days<br>and Still |                 | Total<br>Past Due |                  |                  |
|-----------------------------------|------------------------------|----------------------|-----------------|-------------------|------------------|------------------|
|                                   |                              | Accruing             | Nonaccrual      | Nonaccrual        | Current          | Total            |
| Commercial                        | \$192                        | \$ -                 | \$ 123          | \$ 315            | \$42,392         | \$42,707         |
| Agricultural                      | 69                           | -                    | -               | 69                | 69,972           | 70,041           |
| Real estate – residential         | 7                            | -                    | 149             | 156               | 16,257           | 16,413           |
| Real estate – commercial          | 154                          | -                    | 610             | 764               | 281,769          | 282,533          |
| Real estate - construction & land | -                            | -                    | 90              | 90                | 37,547           | 37,637           |
| Equity Lines of Credit            | 384                          | -                    | 178             | 562               | 36,957           | 37,519           |
| Auto                              | 1,164                        | -                    | 307             | 1,471             | 81,266           | 82,737           |
| Other                             | 42                           | -                    | -               | 42                | 3,817            | 3,859            |
| <b>Total</b>                      | <b>\$2,012</b>               | <b>\$ -</b>          | <b>\$ 1,457</b> | <b>\$ 3,469</b>   | <b>\$569,977</b> | <b>\$573,446</b> |

| <b><u>December 31, 2018</u></b>   | 30-89<br>Days<br>Past<br>Due | 90 Days<br>and Still |                 | Total<br>Past Due |                  |                  |
|-----------------------------------|------------------------------|----------------------|-----------------|-------------------|------------------|------------------|
|                                   |                              | Accruing             | Nonaccrual      | Nonaccrual        | Current          | Total            |
| Commercial                        | \$11                         | \$ -                 | \$ 144          | \$ 155            | \$49,408         | \$49,563         |
| Agricultural                      | -                            | -                    | -               | -                 | 69,160           | 69,160           |
| Real estate – residential         | 154                          | -                    | 155             | 309               | 15,591           | 15,900           |
| Real estate - commercial          | -                            | -                    | 131             | 131               | 271,579          | 271,710          |
| Real estate - construction & land | -                            | -                    | 92              | 92                | 40,069           | 40,161           |
| Equity Lines of Credit            | 596                          | -                    | 186             | 782               | 37,708           | 38,490           |
| Auto                              | 1,725                        | -                    | 401             | 2,126             | 75,009           | 77,135           |
| Other                             | 85                           | -                    | 8               | 93                | 3,987            | 4,080            |
| <b>Total</b>                      | <b>\$2,571</b>               | <b>\$ -</b>          | <b>\$ 1,117</b> | <b>\$ 3,688</b>   | <b>\$562,511</b> | <b>\$566,199</b> |

The following tables show information related to impaired loans at March 31, 2019, in thousands:

| <b><u>As of March 31, 2019:</u></b> | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|-------------------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
| With no related allowance recorded: |                        |                                |                      |                                   |                                  |
| Commercial                          | \$ -                   | \$ -                           | \$ -                 | \$ -                              | \$ -                             |
| Agricultural                        | 250                    | 250                            | -                    | 250                               | 5                                |
| Real estate – residential           | 460                    | 471                            | -                    | 462                               | 9                                |
| Real estate – commercial            | 131                    | 144                            | -                    | 131                               | -                                |
| Real estate – construction & land   | -                      | -                              | -                    | -                                 | -                                |
| Equity Lines of Credit              | -                      | -                              | -                    | -                                 | -                                |
| Auto                                | -                      | -                              | -                    | -                                 | -                                |
| Other                               | -                      | -                              | -                    | -                                 | -                                |
| With an allowance recorded:         |                        |                                |                      |                                   |                                  |
| Commercial                          | \$ 123                 | \$ 128                         | \$ 123               | \$ 123                            | \$ -                             |
| Agricultural                        | -                      | -                              | -                    | -                                 | -                                |
| Real estate – residential           | 179                    | 179                            | 35                   | 179                               | 2                                |
| Real estate – commercial            | 480                    | 480                            | 61                   | 91                                | -                                |
| Real estate – construction & land   | 115                    | 115                            | 10                   | 116                               | 2                                |
| Equity Lines of Credit              | -                      | -                              | -                    | -                                 | -                                |
| Auto                                | -                      | -                              | -                    | -                                 | -                                |
| Other                               | -                      | -                              | -                    | -                                 | -                                |
| Total:                              |                        |                                |                      |                                   |                                  |
| Commercial                          | \$ 123                 | \$ 128                         | \$ 123               | \$ 123                            | \$ -                             |
| Agricultural                        | 250                    | 250                            | -                    | 250                               | 5                                |
| Real estate – residential           | 639                    | 650                            | 35                   | 641                               | 11                               |
| Real estate – commercial            | 611                    | 624                            | 61                   | 222                               | -                                |
| Real estate – construction & land   | 115                    | 115                            | 10                   | 116                               | 2                                |
| Equity Lines of Credit              | -                      | -                              | -                    | -                                 | -                                |
| Auto                                | -                      | -                              | -                    | -                                 | -                                |
| Other                               | -                      | -                              | -                    | -                                 | -                                |
| Total                               | \$ 1,738               | \$ 1,767                       | \$ 229               | \$ 1,352                          | \$ 18                            |

The following tables show information related to impaired loans at December 31, 2018, in thousands:

| <b><u>As of December 31, 2018:</u></b> | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|--|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
| With no related allowance recorded:    |                        |                                |                      |                                   |                                  |
| Commercial                             | \$ -                   | \$ -                           | \$ -                 | \$ -                              | \$ -                             |
| Agricultural                           | 250                    | 250                            | -                    | 252                               | 19                               |
| Real estate – residential              | 470                    | 481                            | -                    | 470                               | 38                               |
| Real estate – commercial               | 131                    | 144                            | -                    | 136                               | -                                |
| Real estate – construction & land      | -                      | -                              | -                    | -                                 | -                                |
| Equity Lines of Credit                 | -                      | -                              | -                    | -                                 | -                                |
| Auto                                   | -                      | -                              | -                    | -                                 | -                                |
| Other                                  | -                      | -                              | -                    | -                                 | -                                |
| With an allowance recorded:            |                        |                                |                      |                                   |                                  |
| Commercial                             | \$ 128                 | \$ 128                         | \$ 128               | \$ 1                              | \$ -                             |
| Agricultural                           | -                      | -                              | -                    | -                                 | -                                |
| Real estate – residential              | 179                    | 179                            | 41                   | 181                               | 7                                |
| Real estate – commercial               | -                      | -                              | -                    | -                                 | -                                |
| Real estate – construction & land      | 117                    | 117                            | 12                   | 120                               | 7                                |
| Equity Lines of Credit                 | -                      | -                              | -                    | -                                 | -                                |
| Auto                                   | -                      | -                              | -                    | -                                 | -                                |
| Other                                  | -                      | -                              | -                    | -                                 | -                                |
| Total:                                 |                        |                                |                      |                                   |                                  |
| Commercial                             | \$ 128                 | \$ 128                         | \$ 128               | \$ 1                              | \$ -                             |
| Agricultural                           | 250                    | 250                            | -                    | 252                               | 19                               |
| Real estate – residential              | 649                    | 660                            | 41                   | 651                               | 45                               |
| Real estate – commercial               | 131                    | 144                            | -                    | 136                               | -                                |
| Real estate – construction & land      | 117                    | 117                            | 12                   | 120                               | 7                                |
| Equity Lines of Credit                 | -                      | -                              | -                    | -                                 | -                                |
| Auto                                   | -                      | -                              | -                    | -                                 | -                                |
| Other                                  | -                      | -                              | -                    | -                                 | -                                |
| Total                                  | \$ 1,275               | \$ 1,299                       | \$ 181               | \$ 1,160                          | \$ 71                            |

## **5. COMMITMENTS AND CONTINGENCIES**

The Company is party to claims and legal proceedings arising in the ordinary course of business. In the opinion of the Company's management, the amount of ultimate liability with respect to such proceedings will not have a material adverse effect on the financial condition or result of operations of the Company taken as a whole.

In the normal course of business, there are various outstanding commitments to extend credit, which are not reflected in the financial statements, including loan commitments of \$118.2 million and \$126.9 million and stand-by letters of credit of \$417 thousand at March 31, 2019 and December 31, 2018.

Of the loan commitments outstanding at March 31, 2019, \$22.0 million are real estate construction loan commitments that are expected to fund within the next twelve months. The remaining commitments primarily relate to revolving lines of credit or other commercial loans, and many of these are expected to expire without being drawn upon. Therefore, the total commitments do not necessarily represent future cash requirements. Each loan commitment and the amount and type of collateral obtained, if any, are evaluated on an individual basis. Collateral held varies, but may include real property, bank deposits, debt or equity securities or business assets.

Stand-by letters of credit are conditional commitments written to guarantee the performance of a customer to a third party. These guarantees are primarily related to the purchases of inventory by commercial customers and are typically short-term in nature. Credit risk is similar to that involved in extending loan commitments to customers and accordingly, evaluation and collateral requirements similar to those for loan commitments are used. The deferred liability related to the Company's stand-by letters of credit was not significant at March 31, 2019 or December 31, 2018.

## **6. RIGHT OF USE ASSETS AND LEASE LIABILITY**

The Company leases four lending offices, three branch offices and two standalone ATM locations. Two of the branch office leases have options to renew. The exercise of lease renewal options is at our sole discretion; therefore, are not included in our Right of Use (ROU) assets and lease liabilities as they are not reasonably certain of exercise. We regularly evaluate the renewal options and when they are reasonably certain of exercise, we include the renewal period in our lease term. We have elected the practical expedient to exclude short-term leases from our ROU assets and lease liabilities. The three branch leases and two of the lending office leases are classified as operating leases while the



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remaining leases are all short-term leases. The Company adopted ASU No. 2016-02 on January 1, 2019 and recorded \$565,000 in ROU assets and lease liabilities on adoption.

As our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at the lease commencement date in determining the present value of the lease payments. The Company's weighted average incremental borrowing rate used in the calculation of the right-of-use assets and lease liabilities was estimated at 5%. At March 31, 2019 the ROU assets and lease liabilities included on the condensed consolidated balance sheet in other assets and other liabilities, respectively totaled \$478,000 consisting of total undiscounted remaining cash flows of \$505,000 less a present value discount of \$27,000.

The following table presents a maturity analysis of the operating lease liability at March 31, 2019, in thousands:

|                                     | Maturities<br>of     |
|-------------------------------------|----------------------|
|                                     | Lease<br>Liabilities |
| Nine months ended December 31, 2019 | \$ 220               |
| Year ended December 31, 2020        | 163                  |
| Year ended December 31, 2021        | 63                   |
| Year ended December 31, 2022        | 59                   |
|                                     | 505                  |
| Less: Present value discount        | (27 )                |
| Lease Liability March 31, 2019      | \$ 478               |

The weighted-average remaining lease term is 2.3 years.

Total lease costs for the three months ended March 31, 2019 was \$109,000 consisting of \$88,000 related to operating leases, \$10,000 related to short-term leases and variable lease expense of \$11,000. Variable lease expense consists primarily of maintenance expense paid to maintain common areas. Rent expense for the three months ended March 31, 2018, prior to the adoption of ASU 2016-02, was \$92,000 which includes \$10,000 related to variable lease expense.

Cash paid on operating leases was \$109,000 for the three months ended March 31, 2019.

The following table presents future minimum rental payments under leases with terms in excess of one year as of December 31, 2018 presented in accordance with ASC Topic 840, "Leases":

| Year Ending  |           |
|--------------|-----------|
| December 31, |           |
| 2019         | \$248,000 |
| 2020         | 163,000   |
| 2021         | 63,000    |
| 2022         | 59,000    |
| 2023         | -         |
|              | \$533,000 |

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**7. EARNINGS PER SHARE**

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which shares in the earnings of the Company. The treasury stock method has been applied to determine the dilutive effect of stock options in computing diluted earnings per share.

|   | <b>For the Three<br/>Months<br/>Ended March<br/>31,</b> |         |
|---|---|---------|
|   | 2019  | 2018    |
| (In thousands, except per share data)                 |   |         |
| <b>Net Income:</b>                                    |   |         |
| Net income  | \$3,818   | \$3,280 |
| <b>Earnings Per Share:</b>                            |   |         |
| Basic earnings per share                              | \$0.74  | \$0.65  |
| Diluted earnings per share                            | \$0.73  | \$0.63  |
| <b>Weighted Average Number of Shares Outstanding:</b> |   |         |
| Basic shares  | 5,144   | 5,071   |
| Diluted shares  | 5,225   | 5,208   |

Stock options not included in the computation of diluted earnings per share, due to shares not being in-the-money and having an antidilutive effect, were 71,100 and 0 for the three months ended March 31, 2019 and 2018, respectively.

**8. STOCK-BASED COMPENSATION**

In 2001, the Company established a Stock Option Plan for which no shares of common stock remain reserved for issuance to employees and directors and no shares are available for future grants as of March 31, 2019.

As of March 31, 2019, all remaining shares in this plan have vested and no compensation cost remains unrecognized.

A summary of the activity within the 2001 Stock Option Plan follows:

|  | <b>Weighted</b> |         |
|--|-----------------|---------|
|  | <b>Average</b>  |         |
| <b>Shares</b>                          | <b>Exercise</b> |         |
|  | <b>Price</b>    |         |
| Options outstanding at January 1, 2019 | 6,193           | \$ 2.95 |
| Options exercised                      | (6,193)         | 2.95    |
| Options outstanding at March 31, 2019  | -               | \$ -    |

In May 2013, the Company established the 2013 Stock Option Plan for which 425,400 shares of common stock are reserved and 236,100 shares are available for future grants as of March 31, 2019. The 2013 Plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid in full at the time the option is exercised. Payment in full for the option price must be made in cash, with Company common stock previously acquired by the optionee and held by the optionee for a period of at least six months, in options of the Optionee that are fully vested and exercisable or in any combination of the foregoing. The options expire on dates determined by the Board of Directors, but not later than ten years from the date of grant.

No options were granted during the three months ended March 31, 2019. During the three months ended March 31, 2018 the Company granted options to purchase 76,000 shares of common stock. The fair value of each option was estimated on the date of grant using the following assumptions.

|   |             |
|---|-------------|
| Expected life of stock options (in years)   | 2018<br>5.1 |
| Risk free interest rate   | 2.38%       |
| Volatility  | 30.4%       |
| Dividend yields   | 1.39%       |
| Weighted-average fair value of options granted during the three months ended March 31, 2018 | \$6.54      |

The Company determines the fair value of options on the date of grant using a Black-Scholes-Merton option pricing model that uses assumptions based on expected option life, expected stock volatility and the risk-free interest rate. The expected volatility assumptions used by the Company are based on the historical volatility of the Company's common stock over the most recent period commensurate with the estimated expected life of the Company's stock options. The Company bases its expected life assumption on its historical experience and on the terms and conditions of the stock options it grants to employees. The risk-free rate is based on the U.S. Treasury yield curve for the periods within the contractual life of the options in effect at the time of the grant.

A summary of the activity within the 2013 Plan follows:

|  |               |                 | <b>Weighted</b>    |                  |  |
|--|---------------|-----------------|--------------------|------------------|--|
|  |               |                 | <b>Weighted</b>    | <b>Average</b>   |  |
|  | <b>Shares</b> | <b>Average</b>  | <b>Remaining</b>   | <b>Intrinsic</b> |  |
|  |               | <b>Exercise</b> | <b>Contractual</b> | <b>Value</b>     |  |
|  |               | <b>Price</b>    | <b>Term</b>        |                  |  |
|  |               |                 | <b>in Years</b>    |                  |  |
| Options outstanding at January 1, 2019 | 196,500       | \$ 13.84        |                    |                  |  |
| Options exercised                      | (7,200 )      | 7.94            |                    |                  |  |
| Options outstanding at March 31, 2019  | 189,300       | \$ 14.07        | 5.2                | \$1,766,000      |  |
| Options exercisable at March 31, 2019  | 113,175       | \$ 10.27        | 4.5                | \$1,446,000      |  |
| Expected to vest after March 31, 2019  | 67,569        | \$ 19.71        | 6.3                | \$320,000        |  |

As of March 31, 2019, there was \$408,000 of total unrecognized compensation cost related to non-vested, share-based compensation. That cost is expected to be recognized over a weighted average period of 2.4 years.

Compensation cost related to stock options recognized in operating results under the 2013 plan was \$50,000 and \$47,000 for the three months ended March 31, 2019 and 2018, respectively. The associated income tax benefit recognized was \$3,000 and \$5,000 for the three months ended March 31, 2019 and March 31, 2018, respectively.

The total fair value of options vested under the 2013 plan during the three months ended March 31, 2019 and 2018 was \$197,000 and \$84,000, respectively. The total intrinsic value of options at time of exercise under the plans was \$251,000 and \$351,000 for the three months ended March 31, 2019 and 2018, respectively.

Cash received from option exercises under the plans for the three months ended March 31, 2019 and 2018 were \$76,000 and \$82,000, respectively. The tax benefit realized for the tax deductions from option exercise totaled \$0 and \$65,000 for the three months ended March 31, 2019 and 2018, respectively.

## **9. INCOME TAXES**

The Company files its income taxes on a consolidated basis with its subsidiary. Income tax expense is the total of current year income tax due or refundable and the change in deferred tax assets and liabilities.

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amount of assets and liabilities and their tax bases. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. A valuation allowance is recognized if, based on the weight of available evidence management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the consolidated statements of income. There have been no significant changes to unrecognized tax benefits or accrued interest and penalties for the three months ended March 31, 2019.

## **10. FAIR VALUE MEASUREMENT**

The Company measures fair value under the fair value hierarchy described below.

Level 1: Quoted prices for identical instruments traded in active exchange markets.

Level 2: Quoted prices (unadjusted) for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3: Model based techniques that use one significant assumption not observable in the market. These unobservable assumptions reflect the Company's estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been



determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings.

### Fair Value of Financial Instruments

The carrying amounts and estimated fair values of financial instruments, at March 31, 2019 follows, in thousands:

|  | Carrying<br>Value | Fair Value Measurements at March 31,<br>2019 Using: |         |         | Total<br>Fair<br>Value |
|--|-------------------|---|---------|---------|------------------------|
|  |                   | Level 1   | Level 2 | Level 3 |                        |
| Financial assets:                                  |                   |   |         |         |                        |
| Cash and cash equivalents                          | \$44,753          | \$44,753  | \$-     | \$-     | \$44,753               |
| Investment securities                              | 173,227           | -   | 173,227 | -       | 173,227                |
| Loans, net   | 569,778           | -   | -       | 598,785 | 598,785                |
| FHLB stock   | 3,027             | -   | -       | -       | N/A                    |
| Accrued interest receivable                        | 3,065             | 5   | 654     | 2,406   | 3,065                  |
| Financial liabilities:                             |                   |   |         |         |                        |
| Deposits   | 730,923           | 676,306   | 54,746  | -       | 731,052                |
| Repurchase agreements                              | 8,910             | -   | 8,910   | -       | 8,910                  |
| Junior subordinated deferrable interest debentures | 10,310            | -   | -       | 7,925   | 7,925                  |
| Accrued interest payable                           | 94                | 12  | 57      | 25      | 94                     |

The carrying amounts and estimated fair values of financial instruments, at December 31, 2018 follows, in thousands:

|  | Carrying Value | Fair Value Measurements at December 31, 2018 Using: |         |         | Total Fair Value |
|--|----------------|---|---------|---------|------------------|
|  |                | Level 1   | Level 2 | Level 3 |                  |
| Financial assets:                                  |                |   |         |         |                  |
| Cash and cash equivalents                          | \$46,686       | \$46,686  | \$-     | \$-     | \$46,686         |
| Investment securities                              | 171,507        | -   | 171,507 | -       | 171,507          |
| Loans, net   | 562,498        | -   | -       | 580,396 | 580,396          |
| FHLB stock   | 3,027          | -   | -       | -       | N/A              |
| Accrued interest receivable                        | 3,345          | 22  | 685     | 2,638   | 3,345            |
| Financial liabilities:                             |                |   |         |         |                  |
| Deposits   | 726,565        | 669,599   | 57,050  | -       | 726,649          |
| Repurchase agreements                              | 13,058         | -   | 13,058  | -       | 13,058           |
| Junior subordinated deferrable interest debentures | 10,310         | -   | -       | 8,092   | 8,092            |
| Accrued interest payable                           | 88             | 11  | 52      | 25      | 88               |

Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. Those estimates that are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision are included in Level 3. Changes in assumptions could significantly affect the fair values presented.

These estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and non-recurring basis as of March 31, 2019 and December 31, 2018, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value:

Assets and liabilities measured at fair value on a recurring basis at March 31, 2019 are summarized below, in thousands:

|  | Fair Value Measurements at |       |              |      |
|--|----------------------------|-------|--------------|------|
|  | March 31, 2019 Using       |       |              |      |
|  | Quoted                     |       |              |      |
|  | Prices                     |       |              |      |
|  | in Significant             |       | Significant  |      |
|  | Active                     | Other | Significant  |      |
| Total  | Markets                    |       | Unobservable |      |
| Fair   | for                        |       | Inputs       |      |
| Value  | Identical                  |       | (Level 3)    |      |
|  | (Level 2)                  |       | Assets       |      |
|  | (Level 1)                  |       |              |      |
| Assets:  |                            |       |              |      |
| U.S. Government-sponsored agencies collateralized by mortgage obligations- residential | \$ 132,088                 | \$ -  | \$ 132,088   | \$ - |
| Obligations of states and political subdivisions                                       | 41,139                     |       | 41,139       |      |
|  | \$ 173,227                 | \$ -  | \$ 173,227   | \$ - |

Assets and liabilities measured at fair value on a recurring basis at December 31, 2018 are summarized below, in thousands:

|  | Fair Value Measurements at<br>December 31, 2018 Using<br>Quoted |   |  |      |
|--|---|---|--|------|
|  | Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |      |
| Total<br>Fair<br>Value   |   |   |  |      |
| Assets:  |   |   |  |      |
| U.S. Government-sponsored agencies collateralized by mortgage obligations- residential | \$ 132,678  | \$-   | \$ 132,678   | \$ - |
| Obligations of states and political subdivisions                                       | 38,829  | 38,829  |  |      |
|  | \$ 171,507  | \$-   | \$ 171,507   | \$ - |

The fair value of securities available-for-sale equals quoted market price, if available. If quoted market prices are not available, fair value is determined using quoted market prices for similar securities or matrix pricing. There were no changes in the valuation techniques used during 2019 or 2018. Transfers between hierarchy measurement levels are recognized by the Company as of the beginning of the reporting period. Changes in fair market value are recorded in other comprehensive income.

Assets and liabilities measured at fair value on a non-recurring basis at March 31, 2019 are summarized below, in thousands:

Fair Value Measurements at March 31,  
2019 Using  
Quoted Significant Significant

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|                           | Total Fair Value | Price in Active Markets for Identical Assets (Level 1) | Other Observable Inputs (Level 2) | Unobservable Inputs (Level 3) | Total Losses |
|---------------------------|------------------|--|-----------------------------------|-------------------------------|--------------|
| Assets:                   |                  |  |                                   |                               |              |
| Impaired loans:           |                  |  |                                   |                               |              |
| Construction and land     | \$418            | \$-  | \$-                               | \$ 418                        | \$ 61        |
| Other real estate:        |                  |  |                                   |                               |              |
| Real estate – residential | 368              | -  | -                                 | 368                           | -            |
| Real estate – commercial  | 347              | -  | -                                 | 347                           | -            |
| Construction and land     | 455              | -  | -                                 | 455                           | -            |
| Total other real estate   | 1,170            | -  | -                                 | 1,170                         | -            |
| Total                     | \$1,588          | \$-  | \$-                               | \$ 1,588                      | \$ 61        |

Assets and liabilities measured at fair value on a non-recurring basis at December 31, 2018 are summarized below, in thousands:

| Fair Value Measurements at December 31, 2018 Using Quoted |   |                                   |                               |          |   |
|---|---|-----------------------------------|-------------------------------|----------|---|
| Total Fair Value  | Prices in Significant                         |                                   | Significant                   |          | Total Gains Three Months Ended March 31, 2018 |
|   | Active Markets for Identical Assets (Level 1) | Other Observable Inputs (Level 2) | Unobservable Inputs (Level 3) |          |   |
| Assets:   |   |                                   |                               |          |   |
| Impaired loans:   |   |                                   |                               |          |   |
| Construction and land                                     | \$-   | \$-                               | \$-                           | \$-      | \$ 3  |
| Other real estate:  |   |                                   |                               |          |   |
| Real estate – residential                                 | 368   | -                                 | -                             | 368      | -   |
| Real estate – commercial                                  | 347   | -                                 | -                             | 347      | -   |
| Construction and land                                     | 455   | -                                 | -                             | 455      | -   |
| Total other real estate                                   | 1,170   | -                                 | -                             | 1,170    | -   |
| Total   | \$1,170                                       | \$-                               | \$-                           | \$ 1,170 | \$ 3  |

Assets and liabilities measured at fair value on a non-recurring basis at December 31, 2018 are summarized below, in thousands:

The Company has no liabilities which are reported at fair value.

The following methods were used to estimate fair value.

Collateral-Dependent Impaired Loans: The Bank does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect partial write-downs, through charge-offs or specific reserve allowances, that are based on fair value estimates of the underlying collateral. The fair value estimates for collateral-dependent impaired loans are generally based on recent real estate appraisals or broker opinions, obtained from independent third parties, which are frequently adjusted by management to reflect current conditions and estimated selling costs (Level 3). Net (losses) gains of (\$61,000) and \$3,000 represent impairment charges recognized during the years ended March 31, 2019 and 2018, respectively, related to the above impaired loans.

Other Real Estate: Nonrecurring adjustments to certain real estate properties classified as other real estate owned are measured at the lower of carrying amount or fair value, less costs to sell. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized. Fair values are generally based on third party appraisals of the property which are commonly adjusted by management to reflect current conditions and selling costs (Level 3).

Appraisals for both collateral-dependent impaired loans and other real estate are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, a member of the Loan Administration Department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On a quarterly basis, the Company compares the actual selling price of similar collateral that has been liquidated to the most recent appraised value for unsold properties to determine what additional adjustment, if any, should be made to the appraisal value to arrive at fair value. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at March 31, 2019 and December 31, 2018 (dollars in thousands):

| Description               | Fair Value<br>3/31/2019 | Fair Value<br>12/31/2018 | Valuation<br>Technique<br>Significant Unobservable Input   | Range<br>(Weighted<br>Average)<br>3/31/2019 | Range<br>(Weighted<br>Average)<br>12/31/2018 |
|---------------------------|-------------------------|--------------------------|--|---|--|
| <u>Impaired Loans:</u>    |                         |                          |  |   |  |
| RE – Commercial           | \$18                    | \$ -                     | Third Party appraisals<br>Management Adjustments to Reflect Current Conditions and Selling Costs | 10% (10%)                                   | N/A  |
| <u>Other Real Estate:</u> |                         |                          |  |   |  |
| RE – Residential          | \$68                    | \$368                    | Third Party appraisals<br>Management Adjustments to Reflect Current Conditions and Selling Costs | 10%-34% (16%)                               | 10%-34% (16%)                                |
| RE – Commercial           | \$47                    | \$347                    | Third Party appraisals<br>Management Adjustments to Reflect Current Conditions and Selling Costs | 16%-17% (16%)                               | 16%-17% (16%)                                |
| Construction and Land     | \$55                    | \$455                    | Third Party appraisals<br>Management Adjustments to Reflect Current Conditions and Selling Costs | 10% - 51% (24%)                             | 10% - 51% (24%)                              |



## **PART I – FINANCIAL INFORMATION**

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

Certain matters discussed in this Quarterly Report 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, among others, (1) significant increases in competitive pressures in the financial services industry; (2) changes in the interest rate environment resulting in reduced margins; (3) general economic conditions, either nationally or regionally, maybe less favorable than expected, resulting in, among other things, a deterioration in credit quality; (4) changes in regulatory environment; (5) loss of key personnel; (6) fluctuations in the real estate market; (7) changes in business conditions and inflation; (8) operational risks including data processing systems failures or fraud; and (9) changes in securities markets. Therefore, the information set forth herein should be carefully considered when evaluating the business prospects of Plumas Bancorp (the “Company”).

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

## **INTRODUCTION**

The following discussion and analysis sets forth certain statistical information relating to the Company as of March 31, 2019 and December 31, 2018 and for the three month periods ended March 31, 2019 and 2018. This discussion should be read in conjunction with the condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and the consolidated financial statements and notes thereto included in Plumas Bancorp’s Annual Report filed on Form 10-K for the year ended December 31, 2018.

Plumas Bancorp trades on The NASDAQ Capital Market under the ticker symbol “PLBC”.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

There have been no changes to the Company's critical accounting policies from those disclosed in the Company's 2018 Annual Report to Shareholders on Form 10-K.

This discussion should be read in conjunction with our unaudited condensed consolidated financial statements, including the notes thereto, appearing elsewhere in this report.

## **OVERVIEW**

Net income increased by \$538 thousand from \$3.3 million during the first quarter of 2018 to \$3.8 million during the current quarter. The increase in earnings was driven by an increase of \$1.8 million in net interest income. The increase in net interest income was partially offset by a \$566 thousand decrease in non-interest income and increases of \$200 thousand in the provision for loan losses, \$235 thousand in non-interest expense and \$294 thousand in income tax expense. Diluted earnings per share increased to \$0.73 during the three months ended March 31, 2019 compared to \$0.63 during the first quarter of 2018.

Total assets at March 31, 2019 were \$831 million, an increase of \$7 million from \$824 million at December 31, 2018. The increase in assets includes increases of \$7.3 million in net loans and \$1.7 million in investment securities. These items were partially offset by a decline of \$1.9 million in cash and cash equivalents. At March 31, 2019, cash and cash equivalents totaled \$44.8 million, net loans were \$569.8 million and investment securities totaled \$173.2 million.

Total deposits increased by \$4.4 million from \$727 million at December 31, 2018 to \$731 million at March 31, 2019. Shareholders' equity increased by \$5.8 million from \$66.9 million at December 31, 2018 to \$72.7 million at March 31, 2019.

The annualized return on average assets was 1.87% for the three months ended March 31, 2019 up from 1.82% for the three months ended March 31, 2018. The annualized return on average common equity decreased slightly from 23.6% during the first quarter of 2018 to 22.2% during the current quarter.

## RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2019

**Net interest income before provision for loan losses.** Net interest income, on a nontax-equivalent basis, was \$9.4 million for the three months ended March 31, 2019, an increase of \$1.8 million, or 24%, from \$7.6 million for the same period in 2018. The increase in net interest income includes an increase of \$2.0 million in interest income and an increase of \$175 thousand in interest expense. Net interest margin for the three months ended March 31, 2019 increased 43 basis points, or 10%, to 4.95%, up from 4.52% for the same period in 2018.

Interest income increased by \$2.0 million, or 26%, to \$9.8 million for the three months ended March 31, 2019, up from \$7.8 million during the same period in 2018. The largest component of the increase in interest income was an increase in interest and fees on loans of \$1.7 million. This increase was related to an increase in average loan balances of \$78 million and an increase in yield on loans of 47 basis points from 5.62% during the 2018 quarter to 6.09% during the current quarter. Included in interest and fees on loans was \$433 thousand in prepayment fees related to the payoff of loans from one client. This client prepaid a total of \$11.6 million in loans some of which had significant prepayment penalties associated with them. Excluding the effect of the \$433 thousand in prepayments fees, yield on loans would have been 5.78% for the three months ended March 31, 2019. Excluding the effect of the prepayment fees during the 2019 quarter, we attribute much of the remaining increase in yield to an increase in the prime interest rate. The average prime interest rate during the first quarter of 2018 was 4.53% and during the current quarter the average prime rate increased to 5.50%. Approximately 26% of our loan portfolio is tied to the prime interest rate.

The following table compares loan balances by type at March 31, 2019 and 2018.

| (dollars in thousands) | Balance   | Percent       | Balance   | Percent       |
|------------------------|-----------|---------------|-----------|---------------|
|                        | at End    | of            | at End    | of            |
|                        | of Period | Loans in Each | of Period | Loans in Each |

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|                                   |                 | Category<br>to  |                 |                 | Category<br>to  |   |
|-----------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|---|
|                                   |                 | Total<br>Loans  |                 |                 | Total<br>Loans  |   |
|                                   | <b>03/31/19</b> | <b>03/31/19</b> | <b>03/31/18</b> | <b>03/31/18</b> | <b>03/31/18</b> |   |
| Commercial                        | \$42,707        | 7.4             | %               | \$41,899        | 8.6             | % |
| Agricultural                      | 70,041          | 12.2            | %               | 55,861          | 11.4            | % |
| Real estate – residential         | 16,413          | 2.9             | %               | 15,609          | 3.2             | % |
| Real estate – commercial          | 282,533         | 49.3            | %               | 243,781         | 49.8            | % |
| Real estate – construction & land | 37,637          | 6.6             | %               | 26,465          | 5.4             | % |
| Equity Lines of Credit            | 37,519          | 6.5             | %               | 39,534          | 8.1             | % |
| Auto                              | 82,737          | 14.4            | %               | 62,155          | 12.7            | % |
| Other                             | 3,859           | 0.7             | %               | 4,038           | 0.8             | % |
| Total Gross Loans                 | \$573,446       | 100             | %               | \$489,342       | 100             | % |

Interest on investment securities increased by \$281 thousand as a result of an increase in yield and growth in the investment portfolio. The average yield on investment securities increased by 21 basis points from 2.48% during the first quarter of 2018 to 2.69% during the three months ended March 31, 2019. The average balance in investment securities increased by \$31.2 million from \$140.1 million during the first quarter of 2018 to \$171.3 million during the current quarter.

Interest expense on deposits increased by \$146 thousand to \$297 thousand for the three months ended March 31, 2019, up from \$151 thousand during the 2018 quarter. This increase mostly relates to an increase in interest expense on money market accounts and time deposits related to the purchase of our new Carson City Branch on October 26, 2018. The average rate paid on the Carson City money market and time deposits exceeds that which Plumas Bank pays in other markets and we would expect some runoff on these accounts as they reprice over time. During the first quarter of 2019 money market accounts housed at our Carson City bank averaged \$15.6 million and time deposits at this branch averaged \$16.8 million. Interest expense on money market accounts increased by \$61 thousand to \$84 thousand related to an increase in average rate paid of 26 basis points and an increase in average balances of \$20.1 million from \$63.2 million during the three months ended March 31, 2018 to \$83.3 million during the current quarter. Interest on time deposits increased by \$83 thousand from \$33 thousand during the three months ended March 31, 2018 to \$116 thousand during the first quarter of 2019. During this same period average time deposits increased by \$11.7 million and the average rate paid on time deposit increased by 55 basis points.

Interest expense on other interest-bearing liabilities increased by \$29 thousand from \$114 thousand during the three months ended March 31, 2018 to \$143 thousand during the current quarter related to an increase in rate paid on junior subordinated debentures. Interest on the debentures, which totaled \$140 thousand during the first quarter of 2019, fluctuates with changes in the 3-month London Interbank Offered Rate (LIBOR) rate.

The following table presents for the three-month periods indicated the distribution of consolidated average assets, liabilities and shareholders' equity. It also presents the amounts of interest income from interest-earning assets and the resultant annualized yields, as well as the amounts of interest expense on interest-bearing liabilities and the resultant cost expressed in both dollars and annualized rate percentages. Average balances are based on daily averages. Nonaccrual loans are included in the calculation of average loans while nonaccrued interest thereon is excluded from the computation of yields earned:

|                                      | For the Three Months Ended |            |        | For the Three Months Ended |            |        |
|--------------------------------------|----------------------------|------------|--------|----------------------------|------------|--------|
|                                      | March 31, 2019             |            |        | March 31, 2018             |            |        |
|                                      | Average                    | Interest   |        | Average                    | Interest   |        |
|                                      | Balance                    | (in        | Yield/ | Balance                    | (in        | Yield/ |
|                                      | (in                        | thousands) | Rate   | (in                        | thousands) | Rate   |
|                                      | thousands)                 |            |        | thousands)                 |            |        |
| <b>Interest-earning assets:</b>      |                            |            |        |                            |            |        |
| Loans (1) (2) (3)                    | \$566,806                  | \$ 8,510   | 6.09 % | \$488,833                  | \$ 6,777   | 5.62 % |
| Investment securities (1)            | 171,268                    | 1,137      | 2.69 % | 140,050                    | 856        | 2.48 % |
| Interest-bearing deposits            | 30,226                     | 179        | 2.40 % | 48,644                     | 185        | 1.54 % |
| Total interest-earning assets        | 768,300                    | 9,826      | 5.19 % | 677,527                    | 7,818      | 4.68 % |
| Cash and due from banks              | 21,435                     |            |        | 19,922                     |            |        |
| Other assets                         | 39,927                     |            |        | 35,032                     |            |        |
| Total assets                         | \$829,662                  |            |        | \$732,481                  |            |        |
| <b>Interest-bearing liabilities:</b> |                            |            |        |                            |            |        |
| NOW deposits                         | \$104,053                  | 24         | 0.09 % | \$100,472                  | 23         | 0.09 % |
| Money market deposits                | 83,288                     | 84         | 0.41 % | 63,215                     | 23         | 0.15 % |
| Savings deposits                     | 179,324                    | 73         | 0.17 % | 175,162                    | 72         | 0.17 % |
| Time deposits                        | 55,669                     | 116        | 0.85 % | 43,922                     | 33         | 0.30 % |
| Total deposits                       | 422,334                    | 297        | 0.29 % | 382,771                    | 151        | 0.16 % |
| Junior subordinated debentures       | 10,310                     | 140        | 5.51 % | 10,310                     | 112        | 4.41 % |
| Other interest-bearing liabilities   | 12,638                     | 3          | 0.10 % | 9,573                      | 2          | 0.08 % |
| Total interest-bearing liabilities   | 445,282                    | 440        | 0.40 % | 402,654                    | 265        | 0.27 % |
| Non-interest bearing deposits        | 307,533                    |            |        | 266,771                    |            |        |
| Other liabilities                    | 7,228                      |            |        | 6,580                      |            |        |
| Shareholders' equity                 | 69,619                     |            |        | 56,476                     |            |        |
| Total liabilities & equity           | \$829,662                  |            |        | \$732,481                  |            |        |

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|   |          |        |          |        |
|---|----------|--------|----------|--------|
| Cost of funding interest-earning assets (4) |          | 0.24 % |          | 0.16 % |
| Net interest income and margin (5)          | \$ 9,386 | 4.95 % | \$ 7,553 | 4.52 % |

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(1) Not computed on a tax-equivalent basis.

(2) Average nonaccrual loan balances of \$1.1 million for 2019 and 2018 are included in average loan balances for computational purposes.

(3) Net fees (costs) included in loan interest income for the three-month periods ended March 31, 2019 and 2018 were \$133,000 and (\$108,000), respectively.

(4) Total annualized interest expense divided by the average balance of total earning assets.

(5) Annualized net interest income divided by the average balance of total earning assets.

The following table sets forth changes in interest income and interest expense for the three-month periods indicated and the amount of change attributable to variances in volume, rates and the combination of volume and rates based on the relative changes of volume and rates:

**2019 over 2018 change in  
net interest income**

**for the three months ended  
March 31**

**(in thousands)**

|  | <b>Volume</b> | <b>Rate</b> | <b>Mix</b> | <b>Total</b> |
|--|---------------|-------------|------------|--------------|
|  | <b>(1)</b>    | <b>(2)</b>  | <b>(3)</b> |              |

**Interest-earning assets:**

|                           |         |       |      |         |
|---------------------------|---------|-------|------|---------|
| Loans                     | \$1,081 | \$562 | \$90 | \$1,733 |
| Investment securities     | 191     | 74    | 16   | 281     |
| Interest bearing deposits | (70 )   | 103   | (39) | (6 )    |
| Total interest income     | 1,202   | 739   | 67   | 2,008   |

**Interest-bearing liabilities:**

|                                |         |       |      |         |
|--------------------------------|---------|-------|------|---------|
| NOW deposits                   | 1       | -     | -    | 1       |
| Money market deposits          | 7       | 41    | 13   | 61      |
| Savings deposits               | 1       | -     | -    | 1       |
| Time deposits                  | 9       | 59    | 15   | 83      |
| Junior subordinated debentures | -       | 28    | -    | 28      |
| Other                          | 1       | -     | -    | 1       |
| Total interest expense         | 19      | 128   | 28   | 175     |
| Net interest income            | \$1,183 | \$611 | \$39 | \$1,833 |

- 
- (1) The volume change in net interest income represents the change in average balance multiplied by the previous quarter's rate.
- (2) The rate change in net interest income represents the change in rate multiplied by the previous quarter's average balance.
- (3) The mix change in net interest income represents the change in average balance multiplied by the change in rate.

**Provision for loan losses.** During the three months ended March 31, 2019 and 2018 we recorded a provision for loan losses of \$400 thousand and \$200 thousand, respectively. See "Analysis of Asset Quality and Allowance for Loan Losses" for a discussion of loan quality trends and the provision for loan losses.

The allowance for loan losses is maintained at a level that management believes will be appropriate to absorb probable incurred losses on existing loans based on an evaluation of the collectability of the loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the

borrower's ability to repay their loan. The allowance for loan losses is based on estimates, and ultimate losses may vary from the current estimates. These estimates are reviewed not less than quarterly and, as adjustments become necessary, they are reported in earnings in the periods in which they become known.

Based on information currently available, management believes that the allowance for loan losses is appropriate to absorb probable incurred losses in the loan portfolio. However, no assurance can be given that the Company may not sustain charge-offs which are in excess of the allowance in any given period.

**Non-interest income.** During the three months ended March 31, 2019, non-interest income totaled \$2.0 million, a decrease of \$566 thousand from the three months ended March 31, 2018. The largest component of this decrease was a decline in gains on sale of SBA loans from \$666 thousand during the three months ended March 31, 2018 to \$244 thousand during the current quarter. Proceeds from SBA loan sales totaled \$6.0 million during the current quarter and \$11.9 million during the 2018 quarter. Loans originated for sale totaled \$3.7 million during the three months ended March 31, 2019 and \$12.6 million during the three months ended March 31, 2018. We attribute some of the decline in originations to the government shutdown. During the shutdown we were unable provide SBA guaranteed loans. Non-interest income benefited during the 2018 quarter from a \$209 thousand gain recorded upon the prospective adoption of a newly effective accounting pronouncement impacting the measurement of equity securities, which in our case consists of stock in our correspondent banks, without a readily determinable fair market value. No gain or loss was recorded on these securities during the current quarter.



The following table describes the components of non-interest income for the three-month periods ended March 31, 2019 and 2018, dollars in thousands:

|   | For the Three Months Ended March 31, |         | Dollar    | Percentage |   |
|---|--------------------------------------|---------|-----------|------------|---|
|   | 2019                                 | 2018    | Change    | Change     |   |
| Service charges on deposit accounts                               | 650                                  | 640     | 10        | 1.6        | % |
| Interchange income  | 513                                  | 491     | 22        | 4.5        | % |
| Gain on sale of loans, net  | 244                                  | 666     | (422 )    | -63.4      | % |
| Loan servicing fees   | 193                                  | 189     | 4         | 2.1        | % |
| Earnings on life insurance policies                               | 82                                   | 83      | (1 )      | -1.2       | % |
| Gain on equity securities with no readily determinable fair value | -                                    | 209     | (209 )    | -100.0     | % |
| Loss on sale of investments                                       | -                                    | (8 )    | 8         | 100.0      | % |
| Other   | 283                                  | 261     | 22        | 8.4        | % |
| Total non-interest income   | \$1,965                              | \$2,531 | \$ (566 ) | -22.4      | % |

**Non-interest expense.** During the three months ended March 31, 2019, total non-interest expense increased by \$235 thousand, or 4%, to \$5.7 million, up from \$5.4 million for the comparable period in 2018. The three largest components of this increase were \$156 thousand in occupancy and equipment expense, \$87 thousand in salary and benefit expense and \$67 thousand in the amortization of core deposit intangibles. The largest reduction in non-interest expense was a \$98 thousand decline in professional fees.

The largest component of the increase in occupancy and equipment costs was \$44 thousand in costs related to our new Carson City, Nevada branch. Other significant components of this increase were increases of \$28 thousand in snow removal costs related to record levels of snow fall in many of our service areas and an increase of \$28 thousand in depreciation expense.

The largest component of the increase in salary and benefit expense was an increase of \$241 thousand in salary expense to \$2.5 million. Of this increase, \$80 thousand relates to our new Carson City Branch. Other components of the increase in salary expense include promotional and merit increases as well as an increase in FTE. Accrued bonus expense increased by \$57 thousand related to an increase in pretax pre-bonus income as the level of bonus expense is directly related to the level of pretax pre-bonus income. The largest decreases in salary and benefit expense was a decline in commissions of \$146 thousand and an increase in the deferral of loan origination costs of \$100 thousand. Commissions relate to our SBA operations and the decrease is consistent with the decrease in SBA loan originations and sales in the comparison periods.

The increase in amortization of intangibles is related to the amortization of the core deposit intangible recorded on the acquisition of the Carson City branch. The decline in professional fees included a decline in consulting costs of \$42 thousand much of which was related to an external review of our compliance management system during the first quarter of 2018.

The following table describes the components of non-interest expense for the three-month periods ended March 31, 2019 and 2018, dollars in thousands:

|   | For the Three Months Ended March 31, |         | Dollar | Percentage |   |
|---|--------------------------------------|---------|--------|------------|---|
|   | 2019                                 | 2018    | Change | Change     |   |
| Salaries and employee benefits          | \$3,200                              | \$3,113 | \$ 87  | 2.8        | % |
| Occupancy and equipment                 | 858                                  | 702     | 156    | 22.2       | % |
| Outside service fees                    | 604                                  | 573     | 31     | 5.4        | % |
| Professional fees                       | 121                                  | 219     | (98 )  | -44.7      | % |
| Telephone and data communication        | 120                                  | 136     | (16 )  | -11.8      | % |
| Director compensation and expenses      | 107                                  | 90      | 17     | 18.9       | % |
| Business development                    | 106                                  | 79      | 27     | 34.2       | % |
| Armored car and courier                 | 89                                   | 77      | 12     | 15.6       | % |
| Advertising and shareholder relations   | 82                                   | 78      | 4      | 5.1        | % |
| Amortization of Core Deposit Intangible | 69                                   | 2       | 67     | 3,350.0    | % |
| Deposit insurance                       | 65                                   | 74      | (9 )   | -12.2      | % |
| Loan collection expenses                | 53                                   | 89      | (36 )  | -40.4      | % |
| Stationery and supplies                 | 26                                   | 28      | (2 )   | -7.1       | % |
| OREO costs                              | 23                                   | 41      | (18 )  | -43.9      | % |
| Gain on Sale of OREO and other vehicles | (9 )                                 | (34 )   | 25     | 73.5       | % |
| Other                                   | 170                                  | 182     | (12 )  | -6.6       | % |
| Total non-interest expense              | \$5,684                              | \$5,449 | \$ 235 | 4.3        | % |

**Provision for income taxes.** The Company recorded an income tax provision of \$1.4 million, or 27.5% of pre-tax income for the three months ended March 31, 2019. This compares to an income tax provision of \$1.2 million or 26.0% of pre-tax income during the first three months of 2018. The percentages for 2019 and 2018 differ from statutory rates as tax exempt items of income such as earnings on Bank owned life insurance and municipal loan and securities interest decrease taxable income. In addition, the 2018 provision included income tax benefits related to the exercise of nonqualified stock options of \$42 thousand.

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amount of assets and liabilities and their tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax asset will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Based upon the analysis of available evidence, management has determined that it is "more likely than not" that all deferred income tax assets as of March 31, 2019 and December 31, 2018 will be fully realized and therefore no valuation allowance was recorded. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

## FINANCIAL CONDITION

**Loan Portfolio.** Gross loans balances increased by \$7 million, or 1%, from \$566 million at December 31, 2018 to \$573 million at March 31, 2019. The increase in loan balances includes increases of \$10.8 million in commercial real estate loans, \$5.6 million in automobile loans, \$0.9 million in agricultural loans and \$0.5 million in residential real estate loans. These increases were partially offset by declines in other loan categories the largest of which were decreases of \$6.9 million in commercial loans and \$2.5 million in construction loans. During the current quarter one client prepaid a total of \$11.6 million in loans consisting of \$4.5 million in commercial loans, \$4.9 million in commercial real estate loans and \$2.2 million in construction loans. The Company continues to manage the mix of its loan portfolio consistent with its identity as a community bank serving the financing needs of all sectors of the area it serves. Although the Company offers a broad array of financing options, it continues to concentrate its focus on small to medium sized commercial businesses. These loans offer diversification as to industries and types of businesses, thus limiting material exposure in any industry concentrations. The Company offers both fixed and floating rate loans and obtains collateral in the form of real property, business assets and deposit accounts, but looks to business and personal cash flows as its primary source of repayment.

As shown in the following table the Company's largest lending categories are commercial real estate loans, auto loans, agricultural loans and commercial loans.

|                                   | Balance<br>at<br>End of<br>Period | Percent<br>of<br>Loans in<br>Each<br>Category<br>to |                           | Balance<br>at<br>End of<br>Period | Percent<br>of<br>Loans in<br>Each<br>Category<br>to |                            |
|-----------------------------------|-----------------------------------|---|---------------------------|-----------------------------------|---|----------------------------|
|                                   |                                   | Total<br>Loans<br>3/31/19                           | Total<br>Loans<br>3/31/19 |                                   | Total<br>Loans<br>12/31/18                          | Total<br>Loans<br>12/31/18 |
| (dollars in thousands)            |                                   |   |                           |                                   |   |                            |
| Commercial                        | \$42,707                          | 7.4   | %                         | \$49,563                          | 8.8   | %                          |
| Agricultural                      | 70,041                            | 12.2  | %                         | 69,160                            | 12.2  | %                          |
| Real estate - residential         | 16,413                            | 2.9   | %                         | 15,900                            | 2.8   | %                          |
| Real estate – commercial          | 282,533                           | 49.3  | %                         | 271,710                           | 48.0  | %                          |
| Real estate – construction & land | 37,637                            | 6.6   | %                         | 40,161                            | 7.1   | %                          |
| Equity Lines of Credit            | 37,519                            | 6.5   | %                         | 38,490                            | 6.8   | %                          |
| Auto                              | 82,737                            | 14.4  | %                         | 77,135                            | 13.6  | %                          |
| Other                             | 3,859                             | 0.7   | %                         | 4,080                             | 0.7   | %                          |
| Total Gross Loans                 | \$573,446                         | 100   | %                         | \$566,199                         | 100   | %                          |

The Company's real estate related loans, including real estate mortgage loans, real estate construction and land development loans, consumer equity lines of credit, and agricultural loans secured by real estate comprised 72% of the total loan portfolio at March 31, 2019. Moreover, the business activities of the Company currently are focused in the California counties of Plumas, Nevada, Placer, Lassen, Modoc, Shasta, and Sierra and in Washoe County in Northern Nevada. Consequently, the results of operations and financial condition of the Company are dependent upon the general trends in these economies and, in particular, the residential and commercial real estate markets. In addition, the concentration of the Company's operations in these areas of Northeastern California and Northwestern Nevada exposes it to greater risk than other banking companies with a wider geographic base in the event of catastrophes, such as earthquakes, fires and floods in these regions.

The rates of interest charged on variable rate loans are set at specific increments in relation to the Company's lending rate or other indexes such as the published prime interest rate or U.S. Treasury rates and vary with changes in these indexes. The frequency in which variable rate loans reprice can vary from one day to several years. At March 31, 2019 and December 31, 2018, approximately 73% and 75%, respectively of the Company's loan portfolio was comprised of variable rate loans. At March 31, 2019 and December 31, 2018, 33% of the variable loans were at their respective floor rate. While real estate mortgage, commercial and consumer lending remain the foundation of the Company's historical loan mix, some changes in the mix have occurred due to the changing economic environment and the resulting change in demand for certain loan types. The most significant change has been an increase in indirect auto lending with automobile loans increasing from 2.5% of gross loans at December 31, 2011 to 14.4% of gross loans at March 31, 2019. The automobile portfolio provides diversification to the loan portfolio in terms of rate, term and balance as these loans tend to have a much shorter term and balance than commercial real-estate loans and are fixed rate. In addition, the Company remains committed to the agricultural industry in Northern California and will continue to pursue high quality agricultural loans. Agricultural loans include both commercial and commercial real estate loans. The Company's agricultural loan balances totaled \$70 million at March 31, 2019 and \$69 million at December 31, 2018.

**Analysis of Asset Quality and Allowance for Loan Losses.** The Company attempts to minimize credit risk through its underwriting and credit review policies. The Company's credit review process includes internally prepared credit reviews as well as contracting with an outside firm to conduct periodic credit reviews. The Company's management and lending officers evaluate the loss exposure of classified and impaired loans on a quarterly basis, or more frequently as loan conditions change. The Management Asset Resolution Committee (MARC) reviews the asset quality of criticized and past due loans on a monthly basis and reports the findings to the full Board of Directors. In management's opinion, this loan review system helps facilitate the early identification of potential criticized loans. The Company has implemented MARC to develop an action plan to significantly reduce nonperforming assets. It consists of the Bank's Chief Executive Officer, Chief Financial Officer and Chief Credit Officer, and the activities are governed by a formal written charter. The MARC meets monthly and reports to the Board of Directors.

More specifically, a formal plan to effect repayment and/or disposition of every significant nonperforming loan relationship is developed and documented for review and on-going oversight by the MARC. Some of the strategies used include but are not limited to: 1) obtaining additional collateral, 2) obtaining additional investor cash infusion, 3) sale of the promissory note to an outside party, 4) proceeding with foreclosure on the underlying collateral, and 5) legal action against borrower/guarantors to encourage settlement of debt and/or collect any deficiency balance owed. Each step includes a benchmark timeline to track progress.

MARC also provides guidance for the maintenance and timely disposition of OREO properties; including developing financing and marketing programs to incent individuals to purchase OREO.

The allowance for loan losses is established through charges to earnings in the form of the provision for loan losses. Loan losses are charged to and recoveries are credited to the allowance for loan losses. The allowance for loan losses is maintained at a level deemed appropriate by management to provide for known and inherent risks in the loan

portfolio. The adequacy of the allowance for loan losses is based upon management's continuing assessment of various factors affecting the collectability of loans; including current economic conditions, maturity of the portfolio, size of the portfolio, industry concentrations, borrower credit history, collateral, the existing allowance for loan losses, independent credit reviews, current charges and recoveries to the allowance for loan losses and the overall quality of the portfolio as determined by management, regulatory agencies, and independent credit review consultants retained by the Company. 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 collectability of a loan is subjective to some degree, but must relate to the borrower's financial condition, cash flow, quality of the borrower's management expertise, collateral and guarantees, and state of the local economy.

Formula allocations are calculated by applying loss factors to outstanding loans with similar characteristics. Loss factors are based on the Company's historical loss experience as adjusted for changes in the business cycle and may be adjusted for significant factors that, in management's judgment, affect the collectability of the portfolio as of the evaluation date. Historical loss data from the beginning of the latest business cycle are incorporated in the loss factors.

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

The following table provides certain information for the dates indicated with respect to the Company's allowance for loan losses as well as charge-off and recovery activity.

| <i>(dollars in thousands)</i>   | <b>For the Three Months Ended</b> |             | <b>For the Year Ended</b> |             |             |
|---|-----------------------------------|-------------|---------------------------|-------------|-------------|
|   | <b>March 31, 2019</b>             | <b>2018</b> | <b>2018</b>               | <b>2017</b> | <b>2016</b> |
| Balance at beginning of period  | \$6,958                           | \$6,669     | \$6,669                   | \$6,549     | \$6,078     |
| Charge-offs:  |                                   |             |                           |             |             |
| Commercial and agricultural   | 16                                | 265         | 325                       | 202         | 268         |
| Real estate mortgage  | -                                 | -           | 25                        | 48          | 292         |
| Real estate construction & land   | -                                 | -           | -                         | -           | 5           |
| Consumer (includes equity LOC & Auto)   | 335                               | 184         | 841                       | 629         | 414         |
| Total charge-offs   | 351                               | 449         | 1,191                     | 879         | 979         |
| Recoveries:   |                                   |             |                           |             |             |
| Commercial and agricultural   | 9                                 | 7           | 83                        | 89          | 53          |
| Real estate mortgage  | 1                                 | 108         | 114                       | 118         | 45          |
| Real estate construction & land   | -                                 | 2           | 3                         | -           | 389         |
| Consumer (includes equity LOC & Auto)   | 50                                | 85          | 280                       | 192         | 163         |
| Total recoveries  | 60                                | 202         | 480                       | 399         | 650         |
| Net charge-offs   | 291                               | 247         | 711                       | 480         | 329         |
| Provision for loan losses   | 400                               | 200         | 1,000                     | 600         | 800         |
| Balance at end of period  | \$7,067                           | \$6,622     | \$6,958                   | \$6,669     | \$6,549     |
| Net charge-offs during the period to average loans (annualized for the three-month periods) | 0.25 %                            | 0.20 %      | 0.14 %                    | 0.10 %      | 0.08 %      |
| Allowance for loan losses to total loans  | 1.23 %                            | 1.35 %      | 1.23 %                    | 1.37 %      | 1.42 %      |

During the three months ended March 31, 2019 and 2018 we recorded a provision for loan losses of \$400 thousand and \$200 thousand, respectively. Net charge-offs totaled \$291 thousand during the three months ended March 31, 2019, an increase of \$44 thousand from \$247 thousand during the three months ended March 31, 2018.

The following table provides a breakdown of the allowance for loan losses at March 31, 2019 and December 31, 2018:

| <i>(dollars in thousands)</i> | Balance | Percent  | Balance | Percent  |
|-------------------------------|---------|----------|---------|----------|
|                               | at      | of       | at      | of       |
|                               | End of  | Loans in | End of  | Loans in |
|                               | Period  | Each     | Period  | Each     |

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|                                       | Category<br>to |             |             | Category<br>to |             |             |
|---------------------------------------|----------------|-------------|-------------|----------------|-------------|-------------|
|                                       | Total<br>Loans |             |             | Total<br>Loans |             |             |
|                                       | <b>2019</b>    | <b>2019</b> | <b>2018</b> | <b>2018</b>    | <b>2018</b> | <b>2018</b> |
| Commercial and agricultural           | \$ 1,338       | 19.6        | %           | \$ 1,452       | 21.0        | %           |
| Real estate mortgage                  | 3,164          | 52.2        | %           | 2,900          | 50.8        | %           |
| Real estate construction & land       | 641            | 6.6         | %           | 758            | 7.1         | %           |
| Consumer (includes equity LOC & Auto) | 1,924          | 21.6        | %           | 1,848          | 21.1        | %           |
| Total                                 | \$ 7,067       | 100.0       | %           | \$ 6,958       | 100.0       | %           |

The allowance for loan losses totaled \$7.1 million at March 31, 2019 and \$7.0 million at December 31, 2018. Specific reserves related to impaired loans increased by \$48 thousand from \$181 thousand at December 31, 2018 to \$229 thousand at March 31, 2019. At least quarterly the Company evaluates each specific reserve and if it determines that the loss represented by the specific reserve is uncollectable it records a charge-off for the uncollectable portion. General reserves were \$6.8 million at March 31, 2019 and December 31, 2018. The allowance for loan losses as a percentage of total loans was 1.23% at March 31, 2019 and December 31, 2018. The percentage of general reserves to unimpaired loans totaled 1.20% at March 31, 2019 and December 31, 2018.



The Company places loans 90 days or more past due on nonaccrual status unless the loan is well secured and in the process of collection. A loan is considered to be in the process of collection if, based on a probable specific event, it is expected that the loan will be repaid or brought current. Generally, this collection period would not exceed 90 days. When a loan is placed on nonaccrual status the Company's general policy is to reverse and charge against current income previously accrued but unpaid interest. Interest income on such loans is subsequently recognized only to the extent that cash is received, and future collection of principal is deemed by management to be probable. Where the collectability of the principal or interest on a loan is considered to be doubtful by management, it is placed on nonaccrual status prior to becoming 90 days delinquent.

Impaired loans 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 difference between impaired loans and nonperforming loans is that impaired loan recognition considers not only loans 90 days or more past due, restructured loans and nonaccrual loans but also may include identified problem loans other than delinquent loans where it is considered probable that we will not collect all amounts due to us (including both principal and interest) in accordance with the contractual terms of the loan agreement.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Company, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above.

Loans restructured (TDRs) and not included in nonperforming loans in the following table totaled \$1.0 million, \$1.0 million, \$1.1 million, \$2.6 million and \$2.0 million at March 31, 2019 and December 31, 2018, 2017, 2016, and 2015, respectively. For additional information related to restructured loans see Note 5 of the Company's Consolidated Financial Statements in Item 8 – Financial Statements and Supplementary Data of this Annual Report on Form 10-K.

The following table sets forth the amount of the Company's nonperforming assets as of the dates indicated.

|   | <b>At<br/>March<br/>31,<br/>2019</b> | <b>At December 31,</b> |             |             |             |
|---|--------------------------------------|------------------------|-------------|-------------|-------------|
|   |                                      | <b>2018</b>            | <b>2017</b> | <b>2016</b> | <b>2015</b> |
|   | <i>(dollars in thousands)</i>        |                        |             |             |             |
| Nonaccrual loans                                  | \$1,457                              | \$1,117                | \$1,226     | \$2,724     | \$4,546     |
| Loans past due 90 days or more and still accruing | -                                    | -                      | 1,796       | -           | -           |

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|  |         |         |         |         |         |
|--|---------|---------|---------|---------|---------|
| Total nonperforming loans                                    | 1,457   | 1,117   | 3,022   | 2,724   | 4,546   |
| Other real estate owned                                      | 1,170   | 1,170   | 1,344   | 735     | 1,756   |
| Other vehicles owned   | 83      | 53      | 35      | 12      | 30      |
| Total nonperforming assets                                   | \$2,710 | \$2,340 | \$4,401 | \$3,471 | \$6,332 |
| Interest income forgone on nonaccrual loans                  | \$26    | \$46    | \$50    | \$164   | \$303   |
| Interest income recorded on a cash basis on nonaccrual loans | \$-     | \$-     | \$-     | \$29    | \$-     |
| Nonperforming loans to total loans                           | 0.21 %  | 0.20 %  | 0.62 %  | 0.59 %  | 1.13 %  |
| Nonperforming assets to total assets                         | 0.33 %  | 0.28 %  | 0.59 %  | 0.53 %  | 1.06 %  |

Nonperforming loans at March 31, 2019 were \$1.5 million, an increase of \$340 thousand from the \$1.1 million balance at December 31, 2018. Specific reserves on nonaccrual loans totaled \$185 thousand at March 31, 2019 and \$128 thousand at December 31, 2018, respectively. Performing loans past due thirty to eighty-nine days were \$2.0 million at March 31, 2019 down from \$2.6 million at December 31, 2018.

A substandard loan is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Total substandard loans increased by \$442 thousand from \$741 thousand at December 31, 2018 to \$1.2 million at March 31, 2019. Loans classified as special mention increased by \$199 thousand from \$4.3 million at December 31, 2018 to \$4.5 million at March 31, 2019. At March 31, 2019, \$33 thousand of performing loans were classified as substandard. Further deterioration in the credit quality of individual performing substandard loans or other adverse circumstances could result in the need to place these loans on nonperforming status.

At March 31, 2019 and December 31, 2018, the Company's recorded investment in impaired loans totaled \$1.7 million and \$1.3 million, respectively. The specific allowance for loan losses related to impaired loans totaled \$229 thousand and \$181 thousand at March 31, 2019 and December 31, 2018, respectively. Additionally, \$11 thousand had been charged off against the impaired loans at March 31, 2019 and December 31, 2018.

It is the policy of management to make additions to the allowance for loan losses so that it remains appropriate to absorb the inherent risk of loss in the portfolio. Management believes that the allowance at March 31, 2019 is appropriate. However, the determination of the amount of the allowance is judgmental and subject to economic conditions which cannot be predicted with certainty. Accordingly, the Company cannot predict whether charge-offs of loans in excess of the allowance may occur in future periods.

OREO represents real property acquired by the Bank either through foreclosure or through a deed in lieu thereof from the borrower. Repossessed assets include vehicles and other commercial assets acquired under agreements with delinquent borrowers. OREO holdings represented six properties totaling \$1.2 million at March 31, 2019 and December 31, 2018. Nonperforming assets as a percentage of total assets were 0.33% at March 31, 2019 and 0.28% at December 31, 2018.

The following table provides a summary of the change in the number and balance of OREO properties for the three months ended March 31, 2019 and 2018, dollars in thousands:

|                   | <b>Three Months Ended</b> |             |          |             |
|-------------------|---------------------------|-------------|----------|-------------|
|                   | <b>March 31,</b>          |             |          |             |
|                   | <b>#</b>                  | <b>2019</b> | <b>#</b> | <b>2018</b> |
| Beginning Balance | 6                         | \$1,170     | 6        | \$1,344     |
| Additions         | -                         | -           | 1        | 114         |
| Dispositions      | -                         | -           | -        | (377 )      |
| Ending Balance    | 6                         | \$1,170     | 7        | \$1,081     |

The disposition in 2018 was related to the sale of a portion of a property.

**Investment Portfolio and Federal Funds Sold.** Total investment securities were \$173.2 million as of March 31, 2019 and \$171.5 million as of December 31, 2018. Unrealized loss on available-for-sale investment securities totaling \$264 thousand were recorded, net of \$78 thousand in tax benefits, as accumulated other comprehensive loss within shareholders' equity at March 31, 2019. Unrealized loss on available-for-sale investment securities totaling \$2.9 million were recorded, net of \$846 thousand in tax benefits, as accumulated other comprehensive income within shareholders' equity at December 31, 2018.

During the three months ended March 31, 2018 the Company sold eighteen available-for-sale investment securities for total proceeds of \$4.2 million recording a \$8 thousand loss on sale. No investments were sold during the three months ended March 31, 2019.

The investment portfolio at March 31, 2019 consisted of \$132.1 million in securities of U.S. Government-sponsored agencies and 122 municipal securities totaling \$41.1 million. The investment portfolio at December 31, 2018 consisted of \$132.7 million in securities of U.S. Government-sponsored agencies and 119 municipal securities totaling \$38.8 million.

There were no Federal funds sold at March 31, 2019 and December 31, 2018; however, the Bank maintained interest earning balances at the Federal Reserve Bank totaling \$17.5 million at March 31, 2019 and \$19.9 million at December 31, 2018. The balances, at March 31, 2019, earn interest at the rate of 2.40%.

The Company classifies its investment securities as available-for-sale or held-to-maturity. Currently all securities are classified as available-for-sale. Securities classified as available-for-sale may be sold to implement the Company's asset/liability management strategies and in response to changes in interest rates, prepayment rates and similar factors.

**Deposits.** Total deposits increased by \$4.4 million from \$727 million at December 31, 2018 to \$731 million at March 31, 2019. This increase was driven by an \$8.1 million increase in non-interest-bearing demand deposits. Additionally, savings accounts increased by \$1.6 million. Partially offsetting these increases were declines in NOW accounts of \$3.0 million and time deposits of \$2.3 million. The Company continues to manage the mix of its deposits consistent with its identity as a community bank serving the financial needs of its customers.

The following table shows the distribution of deposits by type at March 31, 2019 and December 31, 2018.

| (dollars in thousands) | Balance at End of Period | Percent of Deposits in Each Category to Total |             | Percent of Deposits in Each Category to Total |          |
|------------------------|--------------------------|---|-------------|---|----------|
|                        |                          | 3/31/19                                       | 12/31/18    | 3/31/19                                       | 12/31/18 |
| Non-interest bearing   | \$312,121                | 42.7  | % \$304,039 | 41.8  | %        |
| NOW                    | 102,132                  | 14.0  | % 105,107   | 14.5  | %        |
| Money Market           | 82,764                   | 11.3  | % 82,743    | 11.4  | %        |
| Savings                | 179,289                  | 24.5  | % 177,710   | 24.5  | %        |
| Time                   | 54,617                   | 7.5   | % 56,966    | 7.8   | %        |
| Total Deposits         | \$730,923                | 100   | % \$726,565 | 100   | %        |

Deposits represent the Bank's primary source of funds. Deposits are primarily core deposits in that they are demand, savings and time deposits generated from local businesses and individuals. These sources are considered to be relatively stable, long-term relationships thereby enhancing steady growth of the deposit base without major fluctuations in overall deposit balances. The Company experiences, to a small degree, some seasonality with the slower growth period between November through April, and the higher growth period from May through October. In order to assist in meeting any funding demands, the Company maintains a secured borrowing arrangement with the FHLB. There were no brokered deposits at March 31, 2019 or December 31, 2018.

**Short-term Borrowing Arrangements.** The Company is a member of the FHLB and can borrow up to \$210 million from the FHLB secured by commercial and residential mortgage loans with carrying values totaling \$344 million. The Company is required to hold FHLB stock as a condition of membership. At March 31, 2019 and December 31, 2018, the Company held \$3.0 million of FHLB stock which is recorded as a component of other assets. Based on this level of stock holdings at March 31, 2019, the Company can borrow up to \$112.1 million. To borrow the \$210 million in available credit the Company would need to purchase \$2.6 million in additional FHLB stock. In addition to its FHLB borrowing line, the Company has unsecured short-term borrowing agreements with three of its correspondent banks in the amounts of \$20 million, \$11 million and \$10 million. There were no outstanding borrowings to the FHLB or the correspondent banks under these agreements at March 31, 2019 and December 31, 2018.

**Note Payable.** On October 1, 2018 the Company renewed its line of credit, for a one-year term, with the same lender (the "Note"). The maximum amount outstanding at any one time on the Note cannot exceed \$5 million. There were no borrowings on the Note during the three months ended March 31, 2019 or the year ended December 31, 2018. The Note bears interest at a rate of the U.S. "Prime Rate" plus one-quarter percent per annum and is secured by 100 shares of Plumas Bank stock representing the Company's 100% ownership interest in Plumas Bank. Under the Note, the Bank is subject to several negative and affirmative covenants including, but not limited to providing timely financial information, maintaining specified levels of capital, restrictions on additional borrowings, and meeting or exceeding certain capital and asset quality ratios. The Bank was in compliance with all such covenants related to the Note at March 31, 2019 and December 31, 2018.

**Repurchase Agreements.** In 2011 the Bank introduced a new product for its larger business customers which use securities sold under agreements to repurchase as an alternative to interest-bearing deposits. Securities sold under agreements to repurchase totaling \$8.9 million and \$13.1 million at March 31, 2019 and December 31, 2018, respectively are secured by U.S. Government agency securities with a carrying amount of \$21.3 million and \$21.8 million at March 31, 2019 and December 31, 2018, respectively. Interest paid on this product is similar to that which is paid on the Bank's premium money market account; however, these are not deposits and are not FDIC insured.

**Junior Subordinated Deferrable Interest Debentures.** Plumas Statutory Trust I and II are business trust subsidiaries formed by the Company with capital of \$341,000 and \$175,000, respectively, for the sole purpose of issuing trust preferred securities fully and unconditionally guaranteed by the Company.

During 2002, Trust I issued 6,000 Floating Rate Capital Trust Pass-Through Securities ("Trust Preferred Securities"), with a liquidation value of \$1,000 per security, for gross proceeds of \$6,000,000. During 2005, Trust II issued 4,000 Trust Preferred Securities with a liquidation value of \$1,000 per security, for gross proceeds of \$4,000,000. The entire proceeds were invested by Trust I in the amount of \$6,186,000 and Trust II in the amount of \$4,124,000 in Floating Rate Junior Subordinated Deferrable Interest Debentures (the "Subordinated Debentures") issued by the Company, with identical maturity, repricing and payment terms as the Trust Preferred Securities. The Subordinated Debentures represent the sole assets of Trusts I and II.

Trust I's Subordinated Debentures mature on September 26, 2032, bear a current interest rate of 6.01% (based on 3-month LIBOR plus 3.40%), with repricing and payments due quarterly. Trust II's Subordinated Debentures mature on September 28, 2035, bear a current interest rate of 4.09% (based on 3-month LIBOR plus 1.48%), with repricing and payments due quarterly. The interest rate of the Trust Preferred Securities issued by Trust I adjust on each quarterly anniversary date to equal the 3-month LIBOR plus 3.40%. The Trust Preferred Securities issued by Trust II adjust on each quarterly anniversary date to equal the 3-month LIBOR plus 1.48%. Both Trusts I and II have the option to defer payment of the distributions for a period of up to five years, as long as the Company is not in default on the payment of interest on the Subordinated Debentures.

Interest expense recognized by the Company for the three months ended March 31, 2019 and 2018 related to the subordinated debentures was \$140 thousand and \$112 thousand, respectively.

### **Capital Resources**

Shareholders' equity increased by \$5.8 million from \$66.9 million at December 31, 2018 to \$72.7 million at March 31, 2019. The \$5.8 million increase was related to earnings during the first quarter of 2019 of \$3.8 million, a decline in the unrealized loss on investment securities of \$1.9 million and \$0.1 million representing stock option activity.

It is the policy of the Company to periodically distribute excess retained earnings to the shareholders through the payment of cash dividends. Such dividends help promote shareholder value and capital adequacy by enhancing the marketability of the Company's stock. All authority to provide a return to the shareholders in the form of a cash or stock dividend or split rests with the Board of Directors. The Board will periodically, but on no regular schedule, reviews the appropriateness of a cash dividend payment. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. The Company is subject to various restrictions on the payment of dividends.

On October 20, 2016 the Company announced that its Board of Directors approved the reinstatement of a semi-annual cash dividend. The dividend in the amount of \$0.10 per share was paid on November 21, 2016. On May 15, 2017 and November 15, 2017, the Company paid semi-annual cash dividends each of which totaled \$0.14 per share. On May 15, 2018 and November 15, 2018, the Company paid semi-annual cash dividends each of which totaled \$0.18 per share.

**Capital Standards.** In July, 2013, the federal bank regulatory agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks, sometimes called "Basel III". The phase-in period for the final rules began in 2015, with certain of the rules' requirements phased in over a multi-year schedule. Under the final rules minimum requirements increased for both the quantity and quality of capital held by the

Company and the Bank. The new capital rules include a new minimum “common equity Tier 1” ratio of 4.5%, a Tier 1 capital ratio of 6.0% (increased from 4.0%), a total risk-based capital ratio of 8.0%, and a minimum leverage ratio of 4.0% (calculated as Tier 1 capital to average consolidated assets). The effective date of these requirements was January 1, 2015. In addition, the new capital rules include a capital conservation buffer of 2.5% above each of these levels (to be phased in over three years which beginning at 0.625% on January 1, 2016 and increasing by that amount on each subsequent January 1, until reaching 2.5% on January 1, 2019) will be required for banking institutions to avoid restrictions on their ability to pay dividends, repurchase stock or pay discretionary bonuses. Including the capital conservation buffer of 2.5%, the new capital rules would result in the following minimum ratios to be considered well capitalized: (i) a Tier 1 capital ratio of 8.5%, (ii) a common equity Tier 1 capital ratio of 7.0%, and (iii) a total capital ratio of 10.5%. The final rules also implement strict eligibility criteria for regulatory capital instruments.

Plumas Bancorp qualifies for treatment under the Small Bank Holding Company Policy Statement (Regulation Y, Appendix C) (the “Policy Statement”) and is thereby not subject to consolidated capital rules at the bank holding company level. On May 24, 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the “Relief Act”) was signed into law. The Relief Act included a provision to increase the threshold for qualifying for the Policy Statement from \$1 billion to \$3 billion in total assets.

The new capital rules continue to apply to the Bank. Consistent with the Relief Act, however, the federal banking agencies have proposed a new community bank leverage ratio that is intended to simplify the regulatory capital requirements for qualifying community banking organizations. Under the proposal, a qualifying banking organization that so elects would be deemed to have met the well-capitalized ratio requirements under the prompt corrective action framework and would be exempt from the generally applicable new capital rules if it maintains a new “community bank leverage ratio” in excess of 9%. The proposed community bank leverage ratio would be equal to tangible equity (as defined the proposal) divided by average total consolidated assets. To qualify, a banking organization would have to have less than \$10 billion in assets and limited off balance sheet exposures and other assets. We cannot predict whether or when this proposal will be adopted.



The following table sets forth the Bank's actual capital amounts and ratios (dollar amounts in thousands):

|                                 | Actual   |        | Minimum Amount of Capital Required |       |   |        |
|---------------------------------|----------|--------|------------------------------------|-------|---|--------|
|                                 |          |        | For Capital Adequacy Purposes (1)  |       | To be Well-Capitalized Under Prompt Corrective Provisions |        |
|                                 | Amount   | Ratio  | Amount                             | Ratio | Amount  | Ratio  |
| <b>March 31, 2019</b>           |          |        |                                    |       |   |        |
| Common Equity Tier 1 Ratio      | \$80,639 | 12.4 % | \$29,353                           | 4.5 % | \$42,399  | 6.5 %  |
| Tier 1 Leverage Ratio           | 80,639   | 9.7 %  | 33,197                             | 4.0 % | 41,497  | 5.0 %  |
| Tier 1 Risk-Based Capital Ratio | 80,639   | 12.4 % | 39,138                             | 6.0 % | 52,184  | 8.0 %  |
| Total Risk-Based Capital Ratio  | 87,956   | 13.5 % | 52,184                             | 8.0 % | 65,230  | 10.0 % |
| <b>December 31, 2018</b>        |          |        |                                    |       |   |        |
| Common Equity Tier 1 Ratio      | \$76,545 | 11.8 % | \$29,071                           | 4.5 % | \$41,991  | 6.5 %  |
| Tier 1 Leverage Ratio           | 76,545   | 9.3 %  | 32,765                             | 4.0 % | 40,956  | 5.0 %  |
| Tier 1 Risk-Based Capital Ratio | 76,545   | 11.8 % | 38,761                             | 6.0 % | 51,681  | 8.0 %  |
| Total Risk-Based Capital Ratio  | 83,753   | 13.0 % | 51,681                             | 8.0 % | 64,602  | 10.0 % |

(1) Does not include amounts required to maintain the capital conservation buffer under the new capital rules

Management believes that Plumas Bank currently meets all its capital adequacy requirements.

The current and projected capital positions of the Bank and the impact of capital plans and long-term strategies are reviewed regularly by management. The Company policy is to maintain the Bank's ratios above the prescribed well-capitalized ratios at all times.

### **Off-Balance Sheet Arrangements**

**Loan Commitments.** In the normal course of business, there are various commitments outstanding to extend credits that are not reflected in the financial statements. Commitments to extend credit and letters of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Annual review of commercial credit lines, letters of credit and ongoing monitoring of outstanding balances reduces the risk of loss associated with these commitments. As of March 31, 2019, the Company had \$118.2 million in unfunded loan commitments and \$417 thousand in letters of credit. This compares to \$126.9 million in unfunded loan commitments and \$417 thousand in letters of credit at December 31, 2018. Of the \$118.2 million in unfunded loan commitments,

\$68.6 million and \$49.6 million represented commitments to commercial and consumer customers, respectively. Of the total unfunded commitments at March 31, 2019, \$66.7 million were secured by real estate, of which \$27.3 million was secured by commercial real estate and \$39.4 million was secured by residential real estate in the form of equity lines of credit. The commercial loan commitments not secured by real estate primarily represent business lines of credit, while the consumer loan commitments not secured by real estate primarily represent revolving credit card lines and overdraft protection lines. Since some of the commitments are expected to expire without being drawn upon the total commitment amounts do not necessarily represent future cash requirements.

**Leases.** The Company leases three depository branches, four lending offices and two non-branch automated teller machine locations. Total rental expenses under all leases were \$109,000 and \$92,000 during the three months ended March 31, 2019 and 2018, respectively. The expiration dates of the leases vary, with the first such lease expiring during 2019 and the last such lease expiring during 2022.

## **Liquidity**

The Company manages its liquidity to provide the ability to generate funds to support asset growth, meet deposit withdrawals (both anticipated and unanticipated), fund customers' borrowing needs, satisfy maturity of short-term borrowings and maintain reserve requirements. The Company's liquidity needs are managed using assets or liabilities, or both. On the asset side, in addition to cash and due from banks, the Company maintains an investment portfolio which includes unpledged U.S. Government-sponsored agency securities that are classified as available-for-sale. On the liability side, liquidity needs are managed by charging competitive offering rates on deposit products and the use of established lines of credit.

The Company is a member of the FHLB and can borrow up to \$210 million from the FHLB secured by commercial and residential mortgage loans with carrying values totaling \$344 million. See "Short-term Borrowing Arrangements" for additional information on our FHLB borrowing capacity. In addition to its FHLB borrowing line, the Company has unsecured short-term borrowing agreements with three of its correspondent banks in the amounts of \$20 million, \$11 million and \$10 million. There were no outstanding borrowings under the FHLB or the correspondent bank borrowing lines at March 31, 2019 or December 31, 2018.

Customer deposits are the Company's primary source of funds. Total deposits increased by \$4.4 million from \$727 million at December 31, 2018 to \$731 million at March 31, 2019. Deposits are held in various forms with varying maturities. The Company's securities portfolio, Federal funds sold, FHLB advances, and cash and due from banks serve as the primary sources of liquidity, providing adequate funding for loans during periods of high loan demand. During periods of decreased lending, funds obtained from the maturing or sale of investments, loan payments, and new deposits are invested in short-term earning assets, such as cash held at the FRB, Federal funds sold and investment securities, to serve as a source of funding for future loan growth. Management believes that the Company's available sources of funds, including borrowings, will provide adequate liquidity for its operations in the foreseeable future.

**Recent Developments.** On April 17, 2019 the Company declared a semi-annual cash dividend totaling \$0.23 per share, or approximately \$1.2 million, payable on May 15, 2019 to shareholders of record at the close of business day on May 1, 2019.

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

Not required.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Disclosure Controls and Procedures**

The Company's management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of March 31, 2019. The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the U.S. Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of March 31, 2019.

#### **Changes in Internal Control over Financial Reporting**

There were no changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended March 31, 2019 that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

## **PART II — OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

From time to time, the Company and/or its subsidiary are a party to claims and legal proceedings arising in the ordinary course of business. In the opinion of the Company's management, the amount of ultimate liability with respect to such proceedings will not have a material adverse effect on the financial condition or results of operations of the Company taken as a whole.

## **Item 1A RISK FACTORS**

There have been no material changes to the principal risks that we believe are material to our business, results of operations and financial condition, from the risk factors previously disclosed in the 2018 Annual Report on Form 10-K. For a discussion on these risk factors, please see "Item 1A. Risk Factors" contained in the 2018 Annual Report on Form 10-K.

## **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

(a) None.

(b) None.

(c) None.

## **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

## **ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

## **ITEM 5. OTHER INFORMATION**

None.

41

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**ITEM 6. EXHIBITS**

The following documents are included or incorporated by reference in this Quarterly Report on Form 10Q:

3.1 Articles of Incorporation as amended of Registrant included as exhibit 3.1 to the Registrant's Form S-4, File No. 333-84534, which is incorporated by reference herein.

3.2 Bylaws of Registrant as amended on March 16, 2011 included as exhibit 3.2 to the Registrant's Form 10-K for December 31, 2010, which is incorporated by this reference herein.

3.3 Amendment of the Articles of Incorporation of Registrant dated November 1, 2002, is included as exhibit 3.3 to the Registrant's 10-Q for

September 30, 2005, which is incorporated by this reference herein.

3.4 Amendment of the Articles of Incorporation of Registrant dated August 17, 2005, is included as exhibit 3.4 to the Registrant's 10-Q for September 30, 2005, which is incorporated by this reference herein.

4 Specimen form of certificate for Plumas Bancorp included as exhibit 4 to the Registrant's Form S-4, File No. 333-84534, which is incorporated by reference herein.

10.1 Executive Salary Continuation Agreement of Andrew J. Ryback dated December 17, 2008, is included as exhibit 10.1 to the Registrant's 10-K for December 31, 2008, which is incorporated by this reference



herein.

- Split Dollar Agreement of Andrew J. Ryback dated August 23, 2005, is included as  
10.2 Exhibit 10.2 to the Registrant's 8-K filed on October 17, 2005, which is incorporated by this reference herein.

- Amendment to Salary Continuation Agreement of Andrew J. Ryback dated April 1, 2019, is included as  
10.3 Exhibit 10.1 to the Registrant's 8-K filed on April 2, 2019, which is incorporated by this reference herein.

- Amendment to Salary Continuation Agreement of Richard L. Belstock dated April 1, 2019, is included as  
10.4 Exhibit 10.2 to the Registrant's 8-K filed on April 2, 2019, which is incorporated by this reference herein.

- Amendment to Salary Continuation Agreement of BJ North dated April 1, 2019, is included as
- 10.5 Exhibit 10.3 to the Registrant's 8-K filed on April 2, 2019, which is incorporated by this reference herein.
- Salary Continuation Agreement of Aaron Boigon dated April 1, 2019, is included as
- 10.6 Exhibit 10.4 to the Registrant's 8-K filed on April 2, 2019, which is incorporated by this reference herein.
- Promissory Note Dated October 24, 2013, is included as
- 10.7 Exhibit 10.6 to the Registrant's 10-Q filed on November 7, 2013, which is incorporated by this reference herein.
- 10.8 Director Retirement Agreement of John Flournoy dated March 21, 2007, is included as Exhibit 10.8 to Registrant's 10-Q for March 31, 2007, which is incorporated by this reference herein.

- 10.9 Amendment to Salary Continuation Agreement of Andrew J. Ryback dated April 1, 2016, is included as Exhibit 10.1 to the Registrant's 8-K filed on April 4, 2016, which is incorporated by this reference herein.
- 10.10 Salary Continuation Agreement of Richard L. Belstock dated April 1, 2016, is included as Exhibit 10.2 to the Registrant's 8-K filed on April 4, 2016, which is incorporated by this reference herein.
- 10.11 Salary Continuation Agreement of Kerry D. Wilson dated April 1, 2016, is included as Exhibit 10.3 to the Registrant's 8-K filed on April 4, 2016, which is incorporated by this reference herein.
- 10.12 Salary Continuation Agreement of BJ North dated April 1, 2016, is included as Exhibit 10.4 to the Registrant's 8-K filed on April 4, 2016, which is incorporated by this reference herein.
- 10.13 Director Retirement Agreement of Steven M. Coldani dated December 21, 2016, is included as Exhibit 10.13 to the Registrant's 10-K filed on March 17, 2017, which is incorporated by this reference herein.

- 10.18 Amended and Restated Director Retirement Agreement of Daniel E. West dated May 10, 2000, is included as Exhibit 10.18 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.19 Consulting Agreement of Daniel E. West dated May 10, 2000, is included as Exhibit 10.19 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.24 Amended and Restated Director Retirement Agreement of Gerald W. Fletcher dated May 10, 2000, is included as Exhibit 10.24 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.25 Consulting Agreement of Gerald W. Fletcher dated May 10, 2000, is included as Exhibit 10.25 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.33 Amended and Restated Director Retirement Agreement of Terrance J. Reeson dated April 19, 2000, is included as Exhibit 10.33 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.34 Consulting Agreement of Terrance J. Reeson dated May 10, 2000, is included as Exhibit 10.34 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.41 Form of Indemnification Agreement (Plumas Bancorp) is included as Exhibit 10.41 to the Registrant's 10-Q for March 31, 2009, which is incorporated by this reference herein.
- 10.42 Form of Indemnification Agreement (Plumas Bank) is included as Exhibit 10.42 to the Registrant's 10-Q for March 31, 2009, which is incorporated by this reference herein.
- 10.47 2013 Stock Option Plan is included as exhibit 99.1 of the Form S-8 filed September 12, 2013, which is incorporated by this reference herein.
- 10.48 Specimen Form of Incentive Stock Option Agreement under the 2013 Stock Option Plan is included as exhibit 99.2 of the Form S-8 filed September 12, 2013, which is incorporated by this reference herein.
- 10.49 Specimen Form of Nonqualified Stock Option Agreement under the 2013 Stock Option Plan is included as exhibit 99.3 of the Form S-8 filed September 12, 2013, which is incorporated by this reference herein.
- 10.51 First Amendment to Split Dollar Agreement of Andrew J. Ryback, is included as exhibit 10.51 to the Registrant's 10-K for December 31, 2008, which is incorporated by this reference herein.
- 10.66 Director Retirement Agreement of Robert McClintock, is included as Exhibit 10.66 to the Registrant's 10-K filed on March 23, 2012, which is incorporated by this reference herein.
- 10.67 First Amendment to the Plumas Bank Amended and Restated Director Retirement Agreement for Terrance J. Reeson adopted on September 19, 2007, is included as Exhibit 10.67 to the Registrant's 8-K filed on September 25, 2007, which is incorporated by this reference herein.
- 10.69 First Amendment to the Plumas Bank Amended and Restated Director Retirement Agreement for Daniel E. West adopted on September 19, 2007, is included as Exhibit 10.69 to the Registrant's 8-K filed on September 25, 2007, which is incorporated by this reference herein.
- 10.70

First Amendment to the Plumas Bank Amended and Restated Director Retirement Agreement for Gerald W. Fletcher adopted on October 9, 2007, is included as Exhibit 10.70 to the Registrant's 10-Q for September 30, 2007, which is incorporated by this reference herein.

31.1\* Rule 13a-14(a) [Section 302] Certification of Principal Financial Officer dated May 2, 2019.

31.2\* Rule 13a-14(a) [Section 302] Certification of Principal Executive Officer dated May 2, 2019.

32.1\* Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 dated May 2, 2019.

32.2\* Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 dated May 2, 2019.

101.INS\* XBRL Instance Document.

101.SCH\* XBRL Taxonomy Schema.

101.CAL\* XBRL Taxonomy Calculation Linkbase.

101.DEF\* XBRL Taxonomy Definition Linkbase.

101.LAB\* XBRL Taxonomy Label Linkbase.

101.PRE\* XBRL Taxonomy Presentation Linkbase.

\* Filed herewith

## 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.

### PLUMAS BANCORP

(Registrant)

Date: May 2, 2019

/s/ Richard L. Belstock  
Richard L. Belstock  
*Chief Financial Officer*

/s/ Andrew J. Ryback  
Andrew J. Ryback  
Director, *President and Chief Executive Officer*