

PLUMAS BANCORP
Form 10-Q
August 08, 2013

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 JUNE 30, 2013

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)

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California (State or Other Jurisdiction of Incorporation or Organization)	75-2987096 (I.R.S. Employer Identification No.)
35 S. Lindan Avenue, Quincy, California (Address of Principal Executive Offices) Registrant's Telephone Number, Including Area Code (530) 283-7305	95971 (Zip Code)

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

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

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

Large Accelerated Filer <input type="checkbox"/>	Accelerated Filer <input type="checkbox"/>
Non-Accelerated Filer <input type="checkbox"/>	Smaller Reporting Company <input checked="" type="checkbox"/>

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of August 6, 2013. 4,781,539 shares

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

(In thousands, except share data)

	June 30, 2013	December 31, 2012
Assets		
Cash and cash equivalents	\$ 51,701	\$ 44,675
Investment securities available for sale	80,652	80,964
Loans, less allowance for loan losses of \$5,263 at June 30, 2013 and \$5,686 at December 31, 2012	317,923	310,271
Premises and equipment, net	12,848	13,271
Bank owned life insurance	11,333	11,160
Real estate and vehicles acquired through foreclosure	6,714	5,336
Accrued interest receivable and other assets	11,935	12,125
Total assets	\$ 493,106	\$ 477,802
Liabilities and Shareholders' Equity		
Deposits:		
Non-interest bearing	\$ 145,231	\$ 143,646
Interest bearing	287,053	267,916
Total deposits	432,284	411,562
Repurchase agreements	5,440	7,377
Accrued interest payable and other liabilities	5,500	6,703
Subordinated debenture	7,215	
Junior subordinated deferrable interest debentures	10,310	10,310
Total liabilities	460,749	435,952
Commitments and contingencies (Note 6)		
Shareholders' equity:		
Serial preferred stock, no par value; 10,000,000 shares authorized; 3,383 and 11,949 issued and outstanding at June 30, 2013 and December 31, 2012, respectively; aggregate liquidation value of \$3,405 at June 30, 2013 and \$13,667 at December 31, 2012.	3,369	11,855
Common stock, no par value; 22,500,000 shares authorized; issued and outstanding 4,781,539 shares at June 30, 2013 and 4,776,339 at December 31, 2012	6,211	6,093
Retained earnings	23,614	23,573
Accumulated other comprehensive (loss) income	(837)	329
Total shareholders' equity	32,357	41,850
Total liabilities and shareholders' equity	\$ 493,106	\$ 477,802

See notes to unaudited condensed consolidated financial statements.

PLUMAS BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except per share data)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2013	2012	2013	2012
Interest Income:				
Interest and fees on loans	\$ 4,580	\$ 4,387	\$ 8,896	\$ 8,614
Interest on investment securities	270	211	525	396
Other	25	22	48	56
Total interest income	4,875	4,620	9,469	9,066
Interest Expense:				
Interest on deposits	153	225	308	465
Interest on subordinated debenture	160		160	
Interest on junior subordinated deferrable interest debentures	76	93	159	171
Other	24	18	51	38
Total interest expense	413	336	678	674
Net interest income before provision for loan losses	4,462	4,284	8,791	8,392
Provision for Loan Losses	400	300	1,100	900
Net interest income after provision for loan losses	4,062	3,984	7,691	7,492
Non-Interest Income:				
Service charges	943	914	1,818	1,786
Gain on sale of loans	436	238	957	473
Gain on sale of investments		161		211
Earnings on Bank owned life insurance policies	81	86	173	172
Other	237	189	450	373
Total non-interest income	1,697	1,588	3,398	3,015
Non-Interest Expenses:				
Salaries and employee benefits	2,081	2,126	4,301	4,444
Occupancy and equipment	666	786	1,422	1,544
Other	1,554	1,634	2,953	3,143
Total non-interest expenses	4,301	4,546	8,676	9,131
Income before provision for income taxes	1,458	1,026	2,413	1,376
Provision for Income Taxes	567	393	906	519
Net income	891	633	1,507	857
Discount on Redemption of Preferred Stock	530		530	
Preferred Stock Dividends and Discount Accretion	(110)	(171)	(281)	(342)

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Net income available to common shareholders	\$ 1,311	\$ 462	\$ 1,756	\$ 515
Basic earnings per share	\$ 0.27	\$ 0.10	\$ 0.37	\$ 0.11
Diluted earnings per share	\$ 0.27	\$ 0.10	\$ 0.36	\$ 0.11

See notes to unaudited condensed consolidated financial statements.

PLUMAS BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2013	2012	2013	2012
Net income	\$ 891	\$ 633	\$ 1,507	\$ 857
Other comprehensive income (loss) :				
Change in net unrealized gains	(1,698)	132	(1,985)	251
Less: reclassification adjustments for net gains included in net income		(161)		(211)
Net unrealized holding gains (losses)	(1,698)	(29)	(1,985)	40
Income tax effect	701	12	819	(16)
Other comprehensive (loss) income	(997)	(17)	(1,166)	24
Total comprehensive (loss) income	\$ (106)	\$ 616	\$ 341	\$ 881

See notes to unaudited condensed consolidated financial statements.

PLUMAS BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	For the Six Months Ended June 30,	
	2013	2012
Cash Flows from Operating Activities:		
Net income	\$ 1,507	\$ 857
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,100	900
Change in deferred loan origination costs/fees, net	(453)	(357)
Depreciation and amortization	715	657
Stock-based compensation expense	19	76
Amortization of investment security premiums	222	292
Gain on sale of investments		(211)
Gain on sale of loans held for sale	(957)	(473)
Loans originated for sale	(7,581)	(9,188)
Proceeds from loan sales	13,777	8,316
Provision from change in OREO valuation	414	493
Earnings on bank-owned life insurance	(173)	(172)
Decrease in accrued interest receivable and other assets	994	1,153
(Decrease) increase in accrued interest payable and other liabilities	(1,181)	341
Net cash provided by operating activities	8,403	2,684
Cash Flows from Investing Activities:		
Proceeds from matured and called available-for-sale investment securities	13,000	15,180
Proceeds from principal repayments from available-for-sale government-sponsored mortgage-backed securities	4,332	4,520
Purchases of available-for-sale securities	(19,224)	(48,589)
Proceeds from sale of available-for-sale securities		12,282
Net increase in loans	(16,574)	(13,076)
Proceeds from sale of other real estate	1,057	599
Proceeds from sale of other vehicles	77	52
Purchase of premises and equipment	(137)	(841)
Net cash used in investing activities	(17,469)	(29,873)

Continued on next page.

PLUMAS BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

(Continued)

	For the Six Months Ended June 30,	
	2013	2012
Cash Flows from Financing Activities:		
Net increase in demand, interest bearing and savings deposits	\$ 24,981	\$ 7,393
Net decrease in time deposits	(4,259)	(3,702)
Issuance of subordinated debenture, net of discount	7,182	
Issuance of common stock warrant	318	
Repurchase of common stock warrant	(234)	
Redemption of preferred stock	(8,036)	
Payment of dividends on preferred stock	(1,938)	
Proceeds from exercise of stock options	15	
Net decrease in securities sold under agreements to repurchase	(1,937)	(4,524)
Net cash provided by (used in) financing activities	16,092	(833)
Increase in cash and cash equivalents	7,026	(28,022)
Cash and Cash Equivalents at Beginning of Year	44,675	63,076
Cash and Cash Equivalents at End of Period	\$ 51,701	\$ 35,054
 Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for:		
Interest expense	\$ 1,248	\$ 500
Income taxes	30	\$ 2
Non-Cash Investing Activities:		
Real estate and vehicles acquired through foreclosure	\$ 2,831	\$ 174
See notes to unaudited condensed consolidated financial statements.		

PLUMAS BANCORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. GENERAL

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. The Bank's administrative headquarters is in Quincy, California. In addition, the Bank operates a loan administrative office in Reno, Nevada and a lending office specializing in government-guaranteed lending in Auburn, California. 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.

On July 21, 2010, President Barack Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which, in part, permanently raised the current standard maximum deposit insurance amount to \$250,000. In addition, amendments to the Dodd-Frank Act extended unlimited FDIC insurance coverage for noninterest-bearing transaction deposit accounts. This additional unlimited insurance coverage for noninterest-bearing transaction accounts expired on December 31, 2012.

2. REGULATORY MATTERS

On February 15, 2012, the Bank received notice from the Federal Deposit Insurance Corporation (FDIC) and the California Department of Financial Institutions (DFI) that the Consent Order with the FDIC and the DFI which was effective on March 16, 2011 had been terminated. While the Bank is no longer subject to an Order, the Bank entered into an informal agreement with the FDIC and DFI which, among other things, requested that the Bank continue to maintain a Tier 1 Leverage Capital Ratio of 9% which is in excess of that required for well capitalized institutions and continue to reduce its level of classified asset balances that were outstanding as of September 30, 2011 to not more than 50% of Tier 1 Capital plus the allowance for loan losses. At December 31, 2012 this ratio was 32% and the Bank's Tier 1 Leverage Capital Ratio was 10.4%. The FDIC and DFI terminated the informal agreement effective January 24, 2013.

On July 28, 2011 the Company entered into an agreement with the Federal Reserve Bank of San Francisco (the FRB Agreement). Under the terms of the FRB Agreement, Plumas Bancorp agreed to take certain actions that were designed to maintain its financial soundness so that it may continue to serve as a source of strength to the Bank. Among other things, the FRB Agreement required prior written approval related to the payment or taking of dividends and distributions, making any distributions of interest, principal or other sums on subordinated debentures or trust preferred securities, incurrence of debt, and the purchase or redemption of stock. On April 19, 2013 the Company received notice that the FRB Agreement had been terminated.

3. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements include the accounts of the Company and the accounts of its wholly-owned subsidiary, Plumas Bank. Plumas Statutory Trust I and Plumas Statutory Trust II are not consolidated into the Company's consolidated financial statements and, accordingly, are accounted for under the equity method. In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the Company's financial position at June 30, 2013 and the results of its income and its cash flows for the three-month and six-month periods ended June 30, 2013 and 2012. Our condensed consolidated balance sheet at December 31, 2012 is derived from audited financial statements. Certain reclassifications have been made to prior period's balances to conform to classifications used in 2013. Those reclassifications has no impact on net income or shareholders equity.

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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 2012 Annual Report to Shareholders on Form 10-K. The results of income for the three-month and six-month periods ended June 30, 2013 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.

Management has determined that because all of the commercial 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 single customer accounts for more than 10% of the revenues of the Company or the Bank.

4. INVESTMENT SECURITIES AVAILABLE FOR SALE

The amortized cost and estimated fair value of investment securities at June 30, 2013 and December 31, 2012 consisted of the following, in thousands:

	June 30, 2013			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Debt securities:				
U.S. Government-sponsored agencies	\$ 27,211	\$ 45	\$ (127)	\$ 27,129
U.S. Government-sponsored agencies collateralized by mortgage obligations residential	54,865	15	(1,357)	53,523
	\$ 82,076	\$ 60	\$ (1,484)	\$ 80,652

Unrealized losses on available-for-sale investment securities totaling \$1,424,000 were recorded, net of \$587,000 in tax expense, as accumulated other comprehensive income within shareholders' equity at June 30, 2013. No securities were sold during the six months ended June 30, 2013. During the six months ended June 30, 2012, the Company sold eighteen available-for-sale securities for total proceeds of \$12,282,000, which resulted in the recognition of a \$211,000 gain on sale. No securities were sold at a loss during the six months ended June 30, 2012. During the three months ended June 30, 2012, the Company sold fifteen available-for-sale securities for total proceeds of \$7,811,000, which resulted in the recognition of a \$161,000 gain on sale.

	December 31, 2012			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Debt securities:				
U.S. Government-sponsored agencies	\$ 38,291	\$ 154	\$ (3)	\$ 38,442
U.S. Government-sponsored agencies collateralized by mortgage obligations residential	42,112	434	(24)	42,522
	\$ 80,403	\$ 588	\$ (27)	\$ 80,964

Net unrealized gains on available-for-sale investment securities totaling \$561,000 were recorded, net of \$232,000 in tax expense, as accumulated other comprehensive income within shareholders' equity at December 31, 2012. During the year ended December 31, 2012, the Company sold twenty-five available-for-sale investment securities for \$20,773,000, recording a \$403,000 gain on sale. No securities were sold at a loss.

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Investment securities with unrealized losses at June 30, 2013 are summarized and classified according to the duration of the loss period as follows, in thousands:

	Less than 12 Months Fair Value	Unrealized Losses
Debt securities:		
U.S. Government-sponsored agencies	\$ 9,876	\$ 127
U.S. Government-sponsored agencies collateralized by mortgage obligations	51,461	1,357
	\$ 61,337	\$ 1,484

Investment securities with unrealized losses at December 31, 2012 are summarized and classified according to the duration of the loss period as follows, in thousands:

	Less than 12 Months Fair Value	Unrealized Losses
Debt securities:		
U.S. Government-sponsored agencies	\$ 2,004	\$ 3
U.S. Government-sponsored agencies collateralized by mortgage obligations	7,002	24
	\$ 9,006	\$ 27

There were no securities in a loss position for more than twelve months as of June 30, 2013 and December 31, 2012.

At June 30, 2013, the Company held 61 securities of which 44 were in a loss position. Of the securities in a loss position, all were in a loss position for less than twelve months. Of the 44 securities, 8 are U.S. Government-sponsored agencies and 36 are U.S. Government-sponsored agencies collateralized by mortgage obligations. The unrealized losses primarily relate to changes in interest rates and other market 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 June 30, 2013, 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 which may be upon maturity. 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 June 30, 2013 are other than temporarily impaired.

The amortized cost and estimated fair value of investment securities at June 30, 2013 by contractual maturity are shown below, in thousands. 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.

	Estimated Amortized Cost	Estimated Fair Value
Within one year	2,000	2,009
After one year through five years	25,211	25,120
Investment securities not due at a single maturity date:		
Government-guaranteed mortgage-backed securities	54,865	53,523
	\$ 82,076	\$ 80,652

Investment securities with amortized costs totaling \$50,974,000 and \$44,305,000 and estimated fair values totaling \$50,437,000 and \$44,535,000 at June 30, 2013 and December 31, 2012, respectively, were pledged to secure deposits and repurchase agreements.

5. LOANS AND THE ALLOWANCE FOR LOAN LOSSES

Outstanding loans are summarized below, in thousands:

	June 30, 2013	December 31, 2012
Commercial	\$ 30,020	\$ 29,552
Agricultural	36,972	35,124
Real estate residential	32,452	34,666
Real estate commercial	144,229	139,546
Real estate construction and land development	12,121	15,801
Equity lines of credit	37,299	36,873
Auto	24,920	19,283
Other	3,929	4,212
Gross loans	321,942	315,057
Deferred loan costs, net	1,244	900
Allowance for loan losses	(5,263)	(5,686)
Net loans	\$ 317,923	\$ 310,271

The recorded investment in impaired loans totaled \$11,025,000 and \$18,850,000 at June 30, 2013 and December 31, 2012. The Company had specific allowances for loan losses of \$637,000 on impaired loans of \$3,773,000 at June 30, 2013 as compared to specific allowances for loan losses of \$1,186,000 on impaired loans of \$14,334,000 at December 31, 2012. The balance of impaired loans in which no specific reserves were required totaled \$7,252,000 and \$4,516,000 at June 30, 2013 and December 31, 2012, respectively. The average recorded investment in impaired loans for the six months ended June 30, 2013 and June 30, 2012 was \$16,076,000 and \$23,309,000, respectively. The Company recognized \$210,000 and \$331,000 in interest income on a cash basis for impaired loans during the six months ended June 30, 2013 and 2012, respectively. During the three months ended June 30, 2013 and 2012 the Company recognized \$107,000 and \$204,000, respectively.

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, 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.

The carrying value of troubled debt restructurings at June 30, 2013 and December 31, 2012 was \$8,504,000 and \$12,296,000, respectively. The Company has allocated \$465,000 and \$348,000 of specific reserves on loans to customers whose loan terms have been modified in troubled debt restructurings as of June 30, 2013 and December 31, 2012, respectively. The Company was not committed to lend additional amounts on loans classified as troubled debt restructurings at June 30, 2013 and December 31, 2012.

During the three and six month periods ended June 30, 2013 and December 31, 2012, the terms of certain loans were modified as troubled debt restructurings. Modifications involving a reduction of the stated interest rate of the loan was for periods ranging from 1 month to 10 years and those decreased in rates ranged from 0% to 1.5%. For the periods described above, modifications involving an extension of the maturity date were for periods ranging from 1 month to 10 years.

The following table presents loans by class modified as troubled debt restructurings that occurred during the six months ending June 30, 2013, dollars in thousands:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Recorded Investment
Troubled Debt Restructurings:			
Auto	1	8	7

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Total	1	\$	8	\$	7
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The troubled debt restructuring described above resulted in no allowance for loan losses or charge-offs during the six months ending June 30, 2013.

There were no new troubled debt restructurings during the three months ending June 30, 2013.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the six months ended June 30, 2013, dollars in thousands:

	Number of Loans	Recorded Investment
Troubled Debt Restructurings:		
Real estate commercial	1	\$ 1,150
Total	1	\$ 1,150

The following table presents loans by class modified as troubled debt restructurings that occurred during the twelve months ending December 31, 2012, dollars in thousands:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Recorded Investment
Troubled Debt Restructurings:			
Commercial	1	\$ 24	\$ 24
Real Estate:			
Residential	2	819	800
Construction and land development	3	289	289
Commercial	3	2,497	2,491
Auto	2	11	11
Total	11	\$ 3,640	\$ 3,615

The troubled debt restructurings described above decreased the allowance for loan losses by \$118,000 during the twelve months ending December 31, 2012. The troubled debt restructurings described above did not result in charge offs during the twelve months ending December 31, 2012.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the twelve months ended December 31, 2012, dollars in thousands.

	Number of Loans	Recorded Investment
Troubled Debt Restructurings:		
Real estate construction	1	\$ 2,978
Total	1	\$ 2,978

The terms of certain other loans were modified during the six months ending June 30, 2013 and year ending December 31, 2012 that did not meet the definition of a troubled debt restructuring. These loans have a total recorded investment as of June 30, 2013 and December 31, 2012 of \$4 million and \$9 million, respectively.

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These loans which were modified during the six month ended June 30, 2013 and year ended December 31, 2012 did not meet the definition of a troubled debt restructuring as the modification was a delay in a payment ranging from 30 days to 3 months that was considered to be insignificant or the borrower was not considered to be experiencing financial difficulties.

At June 30, 2013 and December 31, 2012, nonaccrual loans totaled \$7,225,000 and \$13,683,000, respectively. Interest foregone on nonaccrual loans totaled \$170,000 and \$350,000 for the six months ended June 30, 2013 and 2012, respectively. Interest foregone on nonaccrual loans totaled \$80,000 and \$150,000 for the three months ended June 30, 2013 and 2012, respectively. Loans past due 90 days or more and on accrual status totaled \$378,000 and \$15,000 at June 30, 2013 and December 31, 2012. Included in the \$378,000 was one loan totaling \$368,000 which was paid current in July, 2013.

Salaries and employee benefits totaling \$672,000 and \$464,000 have been deferred as loan origination costs during the six months ended June 30, 2013 and 2012, respectively. Salaries and employee benefits totaling \$378,000 and \$269,000 have been deferred as loan origination costs during the three months ended June 30, 2013 and 2012, respectively.

The Company assigns a risk rating to all loans and periodically, but not less than annually, performs detailed reviews of all such 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 five major categories, defined as follows:

Pass A pass loan is a strong credit with no existing or known potential weaknesses deserving of management's close attention.

Watch A Watch loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Company's credit position at some future date. Watch loans are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

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.

Loss Loans classified as loss are considered uncollectible and charged off immediately.

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

June 30, 2013

Grade:	Commercial Credit Exposure						Total
	Credit Risk Profile by Internally Assigned Grade						
	Commercial	Agricultural	Real Estate- Residential	Real Estate- Commercial	Real Estate- Construction	Equity LOC	
Pass	\$ 28,111	\$ 36,198	\$ 29,772	\$ 134,484	\$ 11,421	\$ 35,416	\$ 275,402
Watch	879	372	714	5,527	149	156	7,797
Substandard	1,030	402	1,966	4,218	551	1,727	9,894
Doubtful							
Total	\$ 30,020	\$ 36,972	\$ 32,452	\$ 144,229	\$ 12,121	\$ 37,299	\$ 293,093

December 31, 2012

Grade:	Commercial Credit Exposure						Total
	Credit Risk Profile by Internally Assigned Grade						
	Commercial	Agricultural	Real Estate- Residential	Real Estate- Commercial	Real Estate- Construction	Equity LOC	
Pass	\$ 27,260	\$ 33,801	\$ 31,239	\$ 128,919	\$ 10,863	\$ 34,142	\$ 266,224
Watch	1,145	466	751	3,237	149	965	6,713
Substandard	1,138	857	2,676	7,390	4,789	1,766	18,616
Doubtful	9						9
Total	\$ 29,552	\$ 35,124	\$ 34,666	\$ 139,546	\$ 15,801	\$ 36,873	\$ 291,562

Grade:	Consumer Credit Exposure			Consumer Credit Exposure		
	Credit Risk Profile Based on Payment Activity			Credit Risk Profile Based on Payment Activity		
	June 30, 2013			December 31, 2012		
	Auto	Other	Total	Auto	Other	Total
Performing	\$ 24,884	\$ 3,912	\$ 28,796	\$ 19,239	\$ 4,193	\$ 23,432
Non-performing	36	17	53	44	19	63
Total	\$ 24,920	\$ 3,929	\$ 28,849	\$ 19,283	\$ 4,212	\$ 23,495

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

Six months ended

	Commercial	Agricultural	Real Estate- Residential	Real Estate- Commercial	Real Estate- Construction	Equity LOC	Auto	Other	Total
June 30, 2013:									
Beginning balance	\$ 855	\$ 159	\$ 894	\$ 1,656	\$ 950	\$ 736	\$ 289	\$ 147	\$ 5,686
Charge-offs	(353)		(221)	(132)	(735)	(21)	(49)	(98)	(1,609)
Recoveries	28			11		1	28	18	86
Provision	190	24	(69)	120	671	(12)	83	93	1,100
Ending balance	\$ 720	\$ 183	\$ 604	\$ 1,655	\$ 886	\$ 704	\$ 351	\$ 160	\$ 5,263

Three months ended

June 30, 2013:									
Beginning balance	\$ 786	\$ 165	\$ 654	\$ 1,418	\$ 1,600	\$ 708	\$ 290	\$ 156	\$ 5,777
Charge-offs	(200)				(680)	(21)	(27)	(35)	(963)
Recoveries	19			9		1	11	9	49
Provision	115	18	(50)	228	(34)	16	77	30	400
Ending balance	\$ 720	\$ 183	\$ 604	\$ 1,655	\$ 886	\$ 704	\$ 351	\$ 160	\$ 5,263

Six months ended

June 30, 2012:									
Beginning balance	\$ 1,025	\$ 330	\$ 698	\$ 1,925	\$ 2,006	\$ 635	\$ 95	\$ 194	\$ 6,908
Charge-offs	(733)	(250)	(140)	(238)	(98)	(216)	(12)	(105)	(1,792)
Recoveries	45			3	54	8	14	43	167
Provision	643	103	249	(529)	181	185	(6)	74	900
Ending balance	\$ 980	\$ 183	\$ 807	\$ 1,161	\$ 2,143	\$ 612	\$ 91	\$ 206	\$ 6,183

Three months ended

June 30, 2012:									
Beginning balance	\$ 1,103	\$ 216	\$ 534	\$ 1,839	\$ 2,010	\$ 733	\$ 96	\$ 191	\$ 6,722
Charge-offs	(481)		(101)	(141)	24	(216)	(5)	(28)	(948)
Recoveries	35			1	54	5	8	6	109
Provision	323	(33)	374	(538)	55	90	(8)	37	300
Ending balance	\$ 980	\$ 183	\$ 807	\$ 1,161	\$ 2,143	\$ 612	\$ 91	\$ 206	\$ 6,183

Allowance for Loan Losses

June 30, 2013:									
Ending balance	\$ 720	\$ 183	\$ 604	\$ 1,655	\$ 886	\$ 704	\$ 351	\$ 160	\$ 5,263

Ending balance: individually evaluated for impairment	\$ 10	\$	\$ 187	\$ 240	\$ 34	\$ 157	\$ 5	\$ 4	\$ 637
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Ending balance: collectively evaluated for impairment	\$ 710	\$ 183	\$ 417	\$ 1,415	\$ 852	\$ 547	\$ 346	\$ 156	\$ 4,626
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Loans

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Ending balance	\$ 30,020	\$ 36,972	\$ 32,452	\$ 144,229	\$ 12,121	\$ 37,299	\$ 24,920	\$ 3,929	\$ 321,942
Ending balance: individually evaluated for impairment	\$ 1,258	\$ 414	\$ 3,113	\$ 2,776	\$ 2,061	\$ 1,360	\$ 36	\$ 7	\$ 11,025
Ending balance: collectively evaluated for impairment	\$ 28,762	\$ 36,558	\$ 29,339	\$ 141,453	\$ 10,060	\$ 35,939	\$ 24,884	\$ 3,922	\$ 310,917

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December 31, 2012:	Commercial	Agricultural	Real Estate- Residential	Real Estate- Commercial	Real Estate- Construction	Equity LOC	Auto	Other	Total
<u>Allowance for Loan Losses</u>									
Ending balance	\$ 855	\$ 159	\$ 894	\$ 1,656	\$ 950	\$ 736	\$ 289	\$ 147	\$ 5,686
Ending balance: individually evaluated for impairment	\$ 192	\$ 1	\$ 459	\$ 284	\$ 68	\$ 180	\$	\$ 2	\$ 1,186
Ending balance: collectively evaluated for impairment	\$ 663	\$ 158	\$ 435	\$ 1,372	\$ 882	\$ 556	\$ 289	\$ 145	\$ 4,500
<u>Loans</u>									
Ending balance	\$ 29,552	\$ 35,124	\$ 34,666	\$ 139,546	\$ 15,801	\$ 36,873	\$ 19,283	\$ 4,212	\$ 315,057
Ending balance: individually evaluated for impairment	\$ 3,478	\$ 647	\$ 3,598	\$ 4,528	\$ 5,191	\$ 1,360	\$ 44	\$ 4	\$ 18,850
Ending balance: collectively evaluated for impairment	\$ 26,074	\$ 34,477	\$ 31,068	\$ 135,018	\$ 10,610	\$ 35,513	\$ 19,239	\$ 4,208	\$ 296,207

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

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
As of June 30, 2013:						
Commercial:						
Commercial	\$ 198	\$	\$ 1,123	\$ 1,321	\$ 28,699	\$ 30,020
Agricultural		368	148	516	36,456	36,972
Real estate construction	140		336	476	11,645	12,121
Real estate commercial			2,776	2,776	141,453	144,229
Residential:						
Real estate residential	158		1,439	1,597	30,855	32,452
Equity LOC	175		1,360	1,535	35,764	37,299
Consumer:						
Auto	190		36	226	24,694	24,920
Other	73	10	7	90	3,839	3,929
Total	\$ 934	\$ 378	\$ 7,225	\$ 8,537	\$ 313,405	\$ 321,942

As of December 31, 2012:

Commercial:						
Commercial	\$ 329	\$	\$ 3,303	\$ 3,632	\$ 25,920	\$ 29,552
Agricultural			380	380	34,744	35,124
Real estate construction	156		3,314	3,470	12,331	15,801
Real estate commercial	1,271		3,378	4,649	134,897	139,546
Residential:						
Real estate residential	242		1,911	2,153	32,513	34,666
Equity LOC	527		1,349	1,876	34,997	36,873
Consumer:						
Auto	151	11	44	206	19,077	19,283
Other	102	4	4	110	4,102	4,212
Total	\$ 2,778	\$ 15	\$ 13,683	\$ 16,476	\$ 298,581	\$ 315,057

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The following table shows information related to impaired loans at the dates indicated, in thousands:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<u>As of June 30, 2013:</u>					
With no related allowance recorded:					
Commercial	\$ 1,222	\$ 1,602		\$ 2,284	\$ 48
Agricultural	414	645		539	11
Real estate construction	1,542	1,617		4,530	46
Real estate commercial	867	940		1,319	
Real estate residential	2,465	2,476		2,552	54
Equity Lines of Credit	708	708		998	5
Auto	31	31		38	2
Other	3	3		26	
With an allowance recorded:					
Commercial	36	36	\$ 10	49	
Agricultural					
Real estate construction	519	519	34	522	13
Real estate commercial	1,909	1,909	240	1,913	26
Real estate residential	648	648	187	652	5
Equity Lines of Credit	652	787	157	652	
Auto	5	5	5	1	
Other	4	4	4	1	
Total:					
Commercial	1,258	1,638	10	2,333	48
Agricultural	414	645		539	11
Real estate construction	2,061	2,136	34	5,052	59
Real estate commercial	2,776	2,849	240	3,232	26
Real estate residential	3,113	3,124	187	3,204	59
Equity Lines of Credit	1,360	1,495	157	1,650	5
Auto	36	36	5	39	2
Other	7	7	4	27	
Total	\$ 11,025	\$ 11,930	\$ 637	\$ 16,076	\$ 210

As of December 31, 2012:

With no related allowance recorded:					
Commercial	\$ 1,022	\$ 1,398		\$ 1,597	\$ 16
Agricultural	245	725		573	39
Real estate construction	1,429	1,503		1,106	98
Real estate commercial	941	1,013		1,997	96
Real estate residential	343	354		1,336	28
Equity Lines of Credit	490	490		613	22
Auto	44	44		60	5
Other	2	2		45	6
With an allowance recorded:					
Commercial	2,456	2,849	\$ 192	2,765	20
Agricultural	402	402	1	403	20
Real estate construction	3,762	5,187	68	2,056	35
Real estate commercial	3,587	3,588	284	3,473	102
Real estate residential	3,255	3,255	459	2,818	105
Equity Lines of Credit	870	1,082	180	974	5
Auto					
Other	2	2	2		
Total:					
Commercial	3,478	4,247	192	4,362	36
Agricultural	647	1,127	1	976	59

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Real estate construction	5,191	6,690	68	3,162	133
Real estate commercial	4,528	4,601	284	5,470	198
Real estate residential	3,598	3,609	459	4,154	133
Equity Lines of Credit	1,360	1,572	180	1,587	27
Auto	44	44		60	5
Other	4	4	2	45	6
Total	\$ 18,850	\$ 21,894	\$ 1,186	\$ 19,816	\$ 597

6. 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 \$79,051,000 and \$76,030,000 and stand-by letters of credit of \$70,000 and \$110,000 at June 30, 2013 and December 31, 2012, respectively.

Of the loan commitments outstanding at June 30, 2013, \$6,031,000 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 June 30, 2013 or December 31, 2012.

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.

(In thousands, except share and per share data)	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2013	2012	2013	2012
Net Income:				
Net income	\$ 891	\$ 633	\$ 1,507	\$ 857
Discount on redemption of preferred stock	530		530	
Dividends and discount accretion on preferred shares	(110)	(171)	(281)	(342)
Net income available to common shareholders	\$ 1,311	\$ 462	\$ 1,756	\$ 515
Earnings Per Share:				
Basic earnings per share	\$ 0.27	\$ 0.10	\$ 0.37	\$ 0.11
Diluted earnings per share	\$ 0.27	\$ 0.10	\$ 0.36	\$ 0.11
Weighted Average Number of Shares Outstanding:				
Basic shares	4,779	4,776	4,778	4,776
Diluted shares	4,862	4,776	4,842	4,776

Shares of common stock issuable under stock options and warrants for which the exercise prices were greater than the average market prices were not included in the computation of diluted earnings per share due to their antidilutive effect. Stock options and warrants not included in the computation of diluted earnings per share, due to shares not being in-the-money and having an antidilutive effect, were approximately 200,000 and 492,000 for the three month periods ended June 30, 2013 and 2012, respectively. Stock options and warrants not included in the computation of diluted earnings per share, due to shares not being in-the-money and having an antidilutive effect, were approximately 320,000 and 605,000 for the six month periods ended June 30, 2013 and 2012, respectively.

8. STOCK-BASED COMPENSATION

In 2001, the Company established a Stock Option Plan for which 403,793 shares of common stock remain reserved for issuance to employees and directors and no shares are available for future grants as of June 30, 2013. The Plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the 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 or with Company common stock previously acquired by the optionee and held by the optionee for a period of at least six months. The Plan does not provide for the settlement of awards in cash and new shares are issued upon option exercise. The options expire on dates determined by the Board of Directors, but not later than ten years from the date of grant. Upon grant, options vest ratably over a three to five year period.

The Company determines the fair value of the options previously granted 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. The Company also makes assumptions regarding estimated forfeitures that will impact the total compensation expenses recognized under the Plan.

Compensation cost related to stock options recognized in operating results was \$19,000 and \$76,000 for the six months ended June 30, 2013 and 2012, respectively. The associated future income tax benefit recognized was \$1,000 for the six months ended June 30, 2013 and 2012. Compensation cost related to stock options recognized in operating results was \$10,000 for the quarters ended June 30, 2013 and 2012. The associated future income tax benefit recognized was \$0 for the quarters ended June 30, 2013 and 2012.

The following table summarizes information about stock option activity for the six months ended June 30, 2013:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Intrinsic Value (in thousands)
Options outstanding at December 31, 2012	419,806	\$ 8.67		
Options granted				
Options exercised	(5,200)	\$ 2.95		
Options cancelled	(10,813)	\$ 10.32		
Options outstanding at June 30, 2013	403,793	\$ 8.70	3.8	\$ 663
Options exercisable at June 30, 2013	299,200	\$ 10.71	3.1	\$ 323
Expected to vest after June 30, 2013	87,939	\$ 2.95	5.7	\$ 286

At June 30, 2013, there was \$68,000 of total unrecognized compensation cost related to non-vested stock option awards which is expected to be recognized over a weighted-average period of 1.7 years. The total fair value of options vested during the six months ended June 30, 2013 was \$52,000. The total intrinsic value of options exercised during the six months ended June 30, 2013 was \$14,000. Cash received for options exercised during the six months ended June 30, 2013 was \$15,000.

In May 2013, the Company established the 2013 Stock Option Plan for which 500,000 shares of common stock are reserved and available for future grants to employees and directors. No grants have been made under the 2013 plan.

9. INCOME TAXES

The Company files its income taxes on a consolidated basis with its subsidiary. The allocation of income tax expense represents each entity's proportionate share of the consolidated provision for income taxes.

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported 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.

At June 30, 2013 total deferred tax assets were approximately \$6.4 million and total deferred tax liabilities were approximately \$1.2 million for a net deferred tax asset of \$5.2 million. The Company's deferred tax assets primarily relate to net operating loss carry-forwards and timing differences in the tax deductibility of the provision for loan losses, impairment charges on other real estate owned and deferred compensation. Based upon our analysis of available evidence, management of the Company determined that it is more likely than not that all of our deferred income tax assets as of June 30, 2013 and December 31, 2012 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.

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 statement of income. There have been no significant changes to unrecognized tax benefits or accrued interest and penalties for the three months ended June 30, 2013.

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.

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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 June 30, 2013 and December 31, 2012 are as follows, in thousands:

	Carrying Value	Fair Value Measurements at June 30, 2013 Using:			Total Fair Value
		Level 1	Level 2	Level 3	
Financial assets:					
Cash and cash equivalents	\$ 51,701	\$ 51,701			\$ 51,701
Investment securities	80,652		\$ 80,652		80,652
Loans, net	317,923			\$ 322,541	322,541
FHLB stock	2,226				N/A
Accrued interest receivable	1,583		237	1,346	1,583
Financial liabilities:					
Deposits	432,284	365,967	66,413		432,380
Repurchase Agreements	5,440		5,440		5,440
Subordinated debentures	7,215			7,075	7,075
Junior subordinated deferrable interest debentures	10,310			5,936	5,936
Accrued interest payable	99	6	87	6	99

	Carrying Value	Fair Value Measurements at December 31, 2012 Using:			Total Fair Value
		Level 1	Level 2	Level 3	
Financial assets:					
Cash and cash equivalents	\$ 44,675	\$ 44,675			\$ 44,675
Investment securities	80,964		\$ 80,964		80,964
Loans, net	310,271			\$ 313,929	313,929
FHLB stock	1,950				N/A
Accrued interest receivable	1,677		248	1,429	1,677
Financial liabilities:					
Deposits	411,562	340,986	70,696		411,682
Repurchase Agreements	7,377		7,377		7,377
Junior subordinated deferrable interest debentures	10,310			3,191	3,191
Accrued interest payable	1,115	6	90	1,019	1,115

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 methods and assumptions were used by management to estimate the fair value of its financial instruments:

Cash and cash equivalents: The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

Investment securities: Fair values for securities available for sale are generally determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2).

Loans, net: Fair values of loans, excluding loans held for sale, are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

FHLB stock: It was not practicable to determine the fair value of the FHLB stock due to restrictions placed on its transferability.

Deposits: The fair values disclosed for demand deposits, including interest and non-interest demand accounts, savings, and certain types of money market accounts are, by definition, equal to the carrying amount at the reporting date resulting in a Level 1 classification. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Repurchase agreements: The fair value of securities sold under repurchase agreements is estimated based on bid quotations received from brokers using observable inputs and are included as Level 2.

Subordinated debentures: The fair values of the Company's Subordinated Debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.

Junior subordinated deferrable interest debentures: The fair values of the Company's Subordinated Debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.

Accrued interest receivable and payable: The carrying amounts of accrued interest approximate fair value and are considered to be linked in classification to the asset or liability for which they relate.

Commitments to extend credit and letters of credit: The fair value of commitments are estimated using the fees currently charged to enter into similar agreements and are not significant and, therefore, not presented. Commitments to extend credit are primarily for variable rate loans and letters of credit.

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.

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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 June 30, 2013 and December 31, 2012, 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 June 30, 2013 are summarized below, in thousands:

	Total Fair Value	Fair Value Measurements at June 30, 2013 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
U.S. Government-sponsored agencies	\$ 27,129		\$ 27,129	
U.S. Government-sponsored agencies collateralized by mortgage obligations	53,523		53,523	
	\$ 80,652	\$	\$ 80,652	\$

Assets and liabilities measured at fair value on a recurring basis at December 31, 2012 are summarized below, in thousands:

	Total Fair Value	Fair Value Measurements at December 31, 2012 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
U.S. Government-sponsored agencies	\$ 38,442		\$ 38,442	
U.S. Government-sponsored agencies collateralized by mortgage obligations	42,522		42,522	
	\$ 80,964	\$	\$ 80,964	\$

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 2013 or 2012. 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 June 30, 2013 are summarized below, in thousands: