PLUMAS BANCORP
Form 10-K
March 12, 2018

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

FORM 10-K

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2017

or

Transaction report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

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)	(IRS Employer Identification No.)
35 S. Lindan Avenue, Quincy, CA	**95971**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(530) 283-7305**

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

Title of Each Class:	**Name of Each Exchange on which Registered:**
Common Stock, no par value	The NASDAQ Stock Market LLC

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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

Yes No

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

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

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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 Rule12b-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 if the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of June 30, 2017 the aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant was approximately $96.4 million, based on the closing price reported to the Registrant on June 30, 2017 of $21.30 per share.

Shares of Common Stock held by each officer and director have been excluded in that such persons may be deemed to be affiliates. This determination of the affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares of Common Stock of the registrant outstanding as of March 8, 2018 was 5,073,675.

Documents Incorporated by Reference: Portions of the definitive proxy statement for the 2018 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission pursuant to SEC Regulation 14A are incorporated by reference in Part III, Items 10-14.

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PART I

Forward-Looking Information

This Annual Report on Form 10-K includes forward-looking statements and information is subject to the "safe harbor" provisions of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements, which involve Plumas Bancorp's plans, beliefs and goals, refer to estimates or use similar terms, involve certain risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Such risks and uncertainties include, but are not limited to, the following factors:

Local, regional, national and international economic conditions and the impact they may have on us and our customers, and our assessment of that impact on our estimates including, but not limited to, the allowance for loan losses.

The effects of and changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Federal Open Market Committee of the Federal Reserve Board.

The ability of the Plumas Bank to declare and pay dividends to the Company.

Changes imposed by regulatory agencies to increase our capital to a level greater than the current level required for well-capitalized financial institutions (including the implementation of the Basel III standards), the failure to maintain capital above the level required to be well-capitalized under the regulatory capital adequacy guidelines, the availability of capital from private or government sources, or the failure to raise additional capital as needed.

The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters.

The costs and effects of changes in laws and regulations and of other legal and regulatory developments, including, but not limited to, increases in FDIC insurance premiums, the resolution of legal proceedings or regulatory or other governmental inquiries, and the results of regulatory examinations, reviews or other inquires.

Changes in the interest rate environment and volatility of rate sensitive assets and liabilities.

Declines in the health of the economy, nationally or regionally, which could reduce the demand for loans, reduce the ability of borrowers to repay loans and/or reduce the value of real estate collateral securing most of the Company's loans.

Credit quality deterioration, which could cause an increase in the provision for loan and lease losses.

Devaluation of fixed income securities.

Asset/liability matching risks and liquidity risks.

Loss of key personnel.

Operational interruptions including data processing systems failure and fraud.

Our success at managing the risks involved in the foregoing items.

Plumas Bancorp undertakes no obligation to revise or publicly release the results of any revision to these forward-looking statements.

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ITEM 1. BUSINESS

References herein to the "Company," "we," "us" and "our" refer to Plumas Bancorp and its consolidated subsidiary, unless the context indicates otherwise. References to the "Bank" refer to Company's wholly-owned subsidiary, Plumas Bank. References to "Management" refer to the members of the Company's management and references to the "Board of Directors" or the "Board" refer to the Company's Board of Directors.

General

The Company. Plumas Bancorp is a California corporation registered as a bank holding company under the *Bank Holding Company Act* of 1956, as amended, and is headquartered in Quincy, California. The Company was incorporated in January 2002 for the purposes of become Plumas Bank's holding company and acquired all of the outstanding shares of Plumas Bank in June 2002. The Company's principal subsidiary is the Bank, and the Company exists primarily for the purpose of holding the stock of the Bank and of such other subsidiaries it may acquire or establish. At the present time, the Company's only other subsidiaries are Plumas Statutory Trust I and Plumas Statutory Trust II, which were formed in 2002 and 2005 solely to facilitate the issuance of trust preferred securities.

The Company's principal source of income is dividends from the Bank, but the Company may explore supplemental sources of income in the future. The cash outlays of the Company, including (but not limited to) the payment of dividends to shareholders, if and when declared by the Board of Directors, costs of repurchasing Company common stock and the cost of servicing debt, will generally be paid from dividends paid to the Company by the Bank.

At December 31, 2017, the Company had consolidated assets of $745.4 million, deposits of $662.7 million, other liabilities of $27.0 million and shareholders' equity of $55.7 million. The Company's other liabilities include $10.3 million in junior subordinated deferrable interest debentures and $10.1 million in repurchase agreements. These items are described in detail later in this Form 10-K.

Our operations are conducted at 35 South Lindan Avenue, Quincy, California. Our annual, quarterly and other reports, required under the Securities Exchange Act of 1934 and filed with the Securities and Exchange Commission, (the "SEC") are posted and are available at no cost on the Company's website, *www.plumasbank.com*, as soon as reasonably practicable after the Company files such documents with the SEC. These reports are also available through the SEC's website at *www.sec.gov*.

The Bank. The Bank is a California state-chartered bank that was incorporated in July 1980 and opened for business in December 1980. The Bank is not a member of the Federal Reserve System. The Bank's Administrative Office is located at 35 South Lindan Avenue, Quincy, California. At December 31, 2017 the Bank had approximately $745 million in assets, $482 million in net loans and $663 million in deposits (including deposits of $0.4 million from the Company). It is currently the largest independent bank headquartered in Plumas County. The Bank's deposit accounts are insured by the Federal Deposit Insurance Corporation (the "FDIC") up to maximum insurable amounts.

The Bank's primary service area covers the Northeastern portion of California, with Lake Tahoe to the south and the Oregon border to the north. The Bank, through its twelve branch network, serves Washoe County in Nevada and the seven contiguous California counties of Plumas, Nevada, Sierra, Placer, Lassen, Modoc and Shasta. The branches are located in the California communities of Quincy, Portola, Greenville, Truckee, Fall River Mills, Alturas, Susanville, Chester, Tahoe City, Kings Beach and Redding; in addition, during December, 2015 the Bank opened a branch in Reno, Nevada. The Bank maintains sixteen automated teller machines ("ATMs") tied in with major statewide and national networks. In addition to its branch network, the Bank operates a lending office specializing in government-guaranteed lending in Auburn, California and commercial/agricultural lending offices located in Chico, California and Klamath Falls, Oregon. The Bank's primary business is servicing the banking needs of these communities. Its marketing strategy stresses its local ownership and commitment to serve the banking needs of individuals living and working in the Bank's primary service areas.

With a predominant focus on personal service, the Bank has positioned itself as a multi-community independent bank serving the financial needs of individuals and businesses within the Bank's geographic footprint. Our principal retail lending services include consumer, automobile and home equity loans. Our principal commercial lending services include term real estate, commercial and industrial term loans. In addition, we provide government-guaranteed and agricultural loans as well as credit lines. We provide land development and construction loans on a limited basis.

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The Bank’s government-guaranteed lending center headquartered in Auburn, California provides Small Business Administration (SBA) and USDA Rural Development loans to qualified borrowers throughout Northern California, and Northern Nevada. During 2007 the Bank was granted nationwide Preferred Lender status with the U.S. Small Business Administration and we expect government-guaranteed lending to continue to be an important part of our overall lending operation. During 2017 proceeds from the sale of government-guaranteed loans totaled $36.6 million and we generated a gain on sale of $2.0 million. During 2016 proceeds from the sale of government-guaranteed loans totaled $30.7 million and we generated a gain on sale of $1.8 million.

The Agricultural Credit Centers located in Susanville, Chico, and Alturas, California and Klamath Falls, Oregon provide a complete line of credit services in support of the agricultural activities which are key to the continued economic development of the communities we serve. “Ag lending” clients include a full range of individual farming customers, small to medium-sized business farming organizations and corporate farming units.

As of December 31, 2017, the principal areas to which we have directed our lending activities, and the percentage of our total loan portfolio comprised by each, were as follows: (i) commercial real estate – 49.4%; (ii) commercial and industrial loans – 8.1%; (iii) consumer loans (including residential equity lines of credit and automobile loans) – 21.8%; (iv) agricultural loans (including agricultural real estate loans) – 12.1%; (v) residential real estate – 3.4%; and (vi) construction and land development – 5.2% .

In addition to the lending activities noted above, we offer a wide range of deposit products for the retail and commercial banking markets including checking, interest-bearing and premium interest-bearing checking, business sweep, public funds sweep, savings, time deposit and retirement accounts, as well as remote deposit, telephone and mobile banking, including mobile deposit, and internet banking with bill-pay options. Interest bearing deposits include high yield sweep accounts designed for our commercial customers and for public entities such as municipalities. As of December 31, 2017, the Bank had 31,582 deposit accounts with balances totaling approximately $663 million, compared to 30,591 deposit accounts with balances totaling approximately $583 million at December 31, 2016. We attract deposits through our customer-oriented product mix, competitive pricing, convenient locations, mobile and internet banking and remote deposit operations, all provided with a high level of customer service.

Most of our deposits are attracted from individuals, business-related sources and smaller municipal entities. This mix of deposit customers resulted in a relatively modest average deposit balance of approximately $21 thousand at December 31, 2017. However, it makes us less vulnerable to adverse effects from the loss of depositors who may be seeking higher yields in other markets or who may otherwise draw down balances for cash needs.

We also offer a variety of other products and services to complement the lending and deposit services previously reviewed. These include cashier’s checks, bank-by-mail, ATMs, night depository, safe deposit boxes, direct deposit, electronic funds transfers and other customary banking services.

Through our offering of a Remote Deposit product our business customers are able to make non-cash deposits remotely from their physical location. With this product, we have extended our service area and can now meet the deposit needs of customers who may not be located within a convenient distance of one of our branch offices.

The Bank has devoted a substantial amount of time and capital to the improvement of existing Bank services. We added mobile banking services during the first quarter of 2010. During 2015 we enhanced our mobile banking services and began offering mobile deposit services. During the first quarter of 2012 we replaced our ATMs with new state of the art machines that are ADA compliant and capable of accepting check and cash deposits without a deposit envelope. During 2015 we enhanced our mobile banking services and began offering mobile deposit services and in 2018 we began offering the ability for our customers to send money to others from their mobile devices through a linked debit card (“P2P” transfers).

The officers and employees of the Bank are continually engaged in marketing activities, including the evaluation and development of new products and services, to enable the Bank to retain and improve its competitive position in its service area.

We hold no patents or licenses (other than licenses required by appropriate bank regulatory agencies or local governments), franchises, or concessions. Our business has a modest seasonal component due to the heavy agricultural and tourism orientation of some of the communities we serve. We are not dependent on a single customer or group of related customers for a material portion of our deposits. The Company’s management has established loan concentration guidelines as a percentage of capital and evaluates loan concentration levels within a single industry or group of related industries on quarterly basis, or more frequently as loan conditions change. There has been no material effect upon our capital expenditures, earnings, or competitive position as a result of federal, state, or local environmental regulation.

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Commitment to our Communities. The Board of Directors and Management believe that the Company plays an important role in the economic well-being of the communities it serves. Our Bank has a continuing responsibility to provide a wide range of lending and deposit services to both individuals and businesses. These services are tailored to meet the needs of the communities served by the Company and the Bank.

We offer various loan products which encourage job growth and support community economic development. Types of loans offered range from personal and commercial loans to real estate, construction, agricultural, automobile and government-guaranteed loans. Many banking decisions are made locally with the goal of maintaining customer satisfaction through the timely delivery of high quality products and services.

Recent Expansion Activities. On July 31, 2015 the Bank completed its acquisition of the Redding, California, branch of Rabobank N.A. The transaction included the acquisition of approximately $10 million in deposits. The branch, located at 1335 Hilltop Dr. in Redding, now operates as a branch of the Bank. Following the acquisition, the Bank consolidated its preexisting branch Redding branch on Civic Center Drive branch into this location. The Civic Center Drive facility was sold to an unrelated third party in December, 2015.

In December, 2015 the Bank opened a full-service branch located at 5050 Meadowood Mall Circle, Reno, Nevada. This is the Bank’s first branch location outside of California.

Dividends. It is the policy of the Company to periodically distribute excess retained earnings to the shareholders through the payment of cash dividends, subject to the approval of the Board of Directors. 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 to shareholders of record at the close of business day on November 7, 2016. On April 19, 2017 the Company declared a semi-annual cash dividend totaling $0.14 per share which was paid on May 15, 2017 to shareholders of record at the close of business day on May 1, 2017. On October 18, 2017 the Company declared a semi-annual cash dividend totaling $0.14 per share which was paid on November 15, 2017 to shareholders of record at the close of business day on November 1, 2017.

Trust Preferred Securities. During the third quarter of 2002, the Company formed a wholly owned Connecticut statutory business trust, Plumas Statutory Trust I (the “Trust I”). On September 26, 2002, the Company issued to the Trust I, Floating Rate Junior Subordinated Deferrable Interest Debentures due 2032 (the “Debentures”) in the aggregate principal amount of $6,186,000. In exchange for these debentures the Trust I paid the Company $6,186,000. The Trust I funded its purchase of debentures by issuing $6,000,000 in floating rate capital securities (“trust preferred securities”), which were sold to a third party. These trust preferred securities qualify as Tier I capital under current Federal Reserve Board guidelines. The Debentures are the only asset of the Trust I. The interest rate and terms on both instruments are substantially the same. The rate is based on the three-month LIBOR (London Interbank Offered Rate) plus 3.40%, not to exceed 11.9%, adjustable quarterly. The proceeds from the sale of the Debentures were primarily used by the Company to inject capital into the Bank.

During the third quarter of 2005, the Company formed a wholly owned Delaware statutory business trust, Plumas Statutory Trust II (the "Trust II"). On September 28, 2005, the Company issued to the Trust II, Floating Rate Junior Subordinated Deferrable Interest Debentures due 2035 (the "Debentures") in the aggregate principal amount of $4,124,000. In exchange for these debentures the Trust II paid the Company $4,124,000. The Trust II funded its purchase of debentures by issuing $4,000,000 in floating rate capital securities ("trust preferred securities"), which were sold to a third party. These trust preferred securities qualify as Tier I capital under current Federal Reserve Board guidelines. The Debentures are the only asset of the Trust II. The interest rate and terms on both instruments are substantially the same. The rate is based on the three-month LIBOR (London Interbank Offered Rate) plus 1.48%, adjustable quarterly. The proceeds from the sale of the Debentures were primarily used by the Company to inject capital into the Bank.

The trust preferred securities are mandatorily redeemable upon maturity of the Debentures on September 26, 2032 for Trust I and September 28, 2035 for Trust II, or upon earlier redemption as provided in the indenture.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") excludes trust preferred securities issued after May 19, 2010, from being included in Tier 1 capital, unless the issuing company is a bank holding company with less than $500 million in total assets. Trust preferred securities issued prior to that date will continue to count as Tier 1 capital for bank holding companies with less than $15 billion in total assets, such as the Company.

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Neither Trust I nor Trust II are consolidated into the Company’s consolidated financial statements and, accordingly, both entities are accounted for under the equity method and the junior subordinated debentures are reflected as debt on the consolidated balance sheet.

Promissory Note. The Company had a $2.4 million Term Loan outstanding at December 31, 2016 with an unrelated commercial bank. On April 20, 2017 we paid off the remaining balance on the Term Loan. The Company has the ability to borrow $5.0 million from this same bank under a line of credit agreement. There were no outstanding borrowings on the line of credit at December 31, 2016 or December 31, 2017. See “ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS – Financial Condition – Note Payable and Term Loan” for detail information related to these borrowing agreements.

Business Concentrations. No individual or single group of related customer accounts is considered material in relation to the Bank's assets or deposits, or in relation to our overall business. However, at December 31, 2017 approximately 72% of the Bank's total loan portfolio consisted of real estate-secured loans, including real estate mortgage loans, real estate construction loans, consumer equity lines of credit, and agricultural loans secured by real estate. Moreover, our business activities are currently focused in the California counties of Plumas, Nevada, Placer, Lassen, Modoc, Shasta and Sierra and Washoe County in Nevada. Consequently, our results of operations and financial condition are dependent upon the general trends in these economies and, in particular, the residential and commercial real estate markets. In addition, the concentration of our operations in these areas of California and Nevada exposes us to greater risk than other banking companies with a wider geographic base in the event of catastrophes, such as earthquakes, fires, drought and floods in these regions in California and Nevada.

Competition. With respect to commercial bank competitors, the business is largely dominated by a relatively small number of major banks with many offices operating over a wide geographical area. These banks have, among other advantages, the ability to finance wide-ranging and effective advertising campaigns and to allocate their resources to regions of highest yield and demand. Many of the major banks operating in the area offer certain services that we do not offer directly but may offer indirectly through correspondent institutions. By virtue of their greater total capitalization, such banks also have substantially higher lending limits than we do. For customers whose loan demands exceed our legal lending limit, we attempt to arrange for such loans on a participation basis with correspondent or other banks.

In addition to other banks, our competitors include savings institutions, credit unions, and numerous non-banking institutions such as finance companies, leasing companies, insurance companies, brokerage firms, Internet-based lending platforms and investment banking firms. In recent years, increased competition has also developed from specialized finance and non-finance companies that offer wholesale finance, credit card, and other consumer finance services, including on-line banking services and personal financial software. Strong competition for deposit and loan products affects the rates of those products as well as the terms on which they are offered to customers. Mergers between financial institutions have placed additional competitive pressure on banks within the industry to streamline their operations, reduce expenses, and increase revenues. Competition has also intensified due to federal and state interstate banking laws enacted in the mid-1990’s, which permit banking organizations to expand into other states. The relatively large California market has been particularly attractive to out-of-state institutions. The Financial Modernization Act, which became effective March 11, 2000, has made it possible for full affiliations to occur between banks and securities firms, insurance companies, and other financial companies, and has also intensified competitive conditions.

Currently, within towns in which the Bank has a branch there are 107 banking branch offices of competing institutions (excluding credit unions, but including savings banks), including 70 branches of 10 banks having assets in excess of $10 billion. As of June 30, 2017, the FDIC estimated the Bank's market share of insured deposits within the communities it serves to be as follows: Greenville and Portola 100%, Quincy 87%, Chester 66%, Alturas 59%, Fall River Mills 34%, Kings Beach 33%, Susanville 30%, Truckee 17%, Tahoe City 13%, Redding 1% and Reno less than 1%.

Technological innovations have also resulted in increased competition in financial services markets. Such innovation has, for example, made it possible for non-depository institutions to offer customers automated transfer payment services that previously were considered traditional banking products. In addition, many customers now expect a choice of delivery systems and channels, including home computer, mobile, remote deposit, telephone, ATMs, mail, full-service branches and/or in-store branches. The sources of competition in such products include traditional banks as well as savings associations, credit unions, brokerage firms, money market and other mutual funds, asset management groups, finance and insurance companies, internet-only financial intermediaries, and mortgage banking firms.

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For many years we have countered rising competition by providing our own style of community-oriented, personalized service. We rely on local promotional activity, personal contacts by our officers, directors, employees, and shareholders, automated 24-hour banking, and the individualized service that we can provide through our flexible policies. This approach appears to be well-received by our customers who appreciate a more personal and customer-oriented environment in which to conduct their financial transactions. To meet the needs of customers who prefer to bank electronically, we offer telephone banking, mobile banking, remote deposit, mobile deposit and internet banking with bill payment capabilities. This high tech and high touch approach allows the customers to tailor their access to our services based on their particular preference.

Employees. At December 31, 2017, the Company and its subsidiary employed 161 persons. On a full-time equivalent basis, we employed 142 persons. None of the Company's employees are represented by a labor union, and management considers its relations with employees to be good.

Code of Ethics. The Board of Directors has adopted a code of business conduct and ethics for directors, officers (including the Company's principal executive officer and principal financial officer) and financial personnel, known as the Corporate Governance Code of Ethics. This Code of Ethics is available on the Company's website at www.plumasbank.com. Shareholders may request a free copy of the Code of Ethics Policy from Plumas Bancorp, Ms. Elizabeth Kuipers, Investor Relations, 35 S. Lindan Avenue, Quincy, California 95971.

Supervision and Regulation

General. As financial institution, we are extensively regulated under federal and state law. These laws and regulations are generally intended to protect depositors and customers, not shareholders. To the extent that the following information describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statute or regulation. Our operations may be affected by legislative changes and by the policies of various regulatory authorities. Any change in applicable laws or regulations may have a material effect on our business and prospects. We cannot accurately predict the nature or the extent of the effects on our business and earnings that fiscal or monetary policies, or new federal or state legislation may have in the future.

Holding Company Regulation. We are a registered bank holding company under the Bank Holding Company Act of 1956, as amended, and are subject to the supervision of, and regulation by, the Board of Governors of the Federal Reserve System (the "FRB"). We are required to file reports with the FRB and the FRB periodically examines the Company. A bank holding company is required to serve as a source of financial and managerial strength to its subsidiary bank and, under appropriate circumstances, to commit resources to support the subsidiary bank. FRB regulations require the Company to meet or exceed certain capital requirements and regulate provisions of certain bank holding company debt. The Company is also a bank holding company within the meaning of Section 3700 of the California Financial Code. Therefore, the Company and any of its subsidiaries are subject to supervision and examination by, and may be required to file reports with, the California Department of Business Oversight ("DBO").

Federal and State Bank Regulation. As a California-chartered commercial bank with deposits insured by the FDIC, the Bank is subject to the supervision and regulation of the DBO and the FDIC, as well as certain of the regulations of the FRB and the Consumer Financial Protection Bureau ("CFPB"). The DBO and the FDIC regularly examine the Bank and may prohibit the Bank from engaging in what they believe constitute unsafe or unsound banking practices or violations of law.

Securities Regulation. The Company is subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, both as administered by the Securities and Exchange Commission. As a listed company on NASDAQ, we are subject to NASDAQ rules for listed companies.

Capital Adequacy. The FDIC has risk-based capital adequacy guidelines intended to provide a measure of capital adequacy that reflects the degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets, and transactions, such as letters of credit and recourse arrangements, which are reported as off-balance-sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off-balance-sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as certain U.S. government securities, to 100% for assets with relatively higher credit risk, such as business loans.

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A banking organization’s risk-based capital ratios are obtained by dividing its qualifying capital by its total risk-adjusted assets and off-balance-sheet items. The regulators measure risk-adjusted assets and off-balance-sheet items against both total qualifying capital (the sum of Tier 1 capital and limited amounts of Tier 2 capital) and Tier 1 capital. Tier 1 capital consists of common stock, retained earnings, noncumulative perpetual preferred stock and minority interests in certain subsidiaries, less most other intangible assets. Tier 2 capital may consist of a limited amount of the allowance for loan and lease losses and certain other instruments with some characteristics of equity. The inclusion of elements of Tier 2 capital is subject to certain other requirements and limitations of the federal banking agencies.

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. When fully phased in and including the capital conservation buffer of 2.5%, the new capital rules would result in the following minimum ratios for the Bank 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 new capital rules also implement strict eligibility criteria for regulatory capital instruments.

Under the new capital rules, the minimum capital ratios (including the applicable increment of the capital conservation buffer) as of January 1, 2017 were as follows: a common equity Tier 1 capital ratio of 5.75%; a Tier 1 capital ratio of 7.25%; a total capital risk-based capital ratio of 9.25% and a minimum leverage ratio of 4.0%. As of January 1, 2018, the required minimum ratios for common equity Tier 1 capital, Tier 1 capital and total risk-based capital will increase by the capital conservation buffer increment of 0.625%, to 6.375%, 7.875% and 9.875% respectively.

A bank that does not achieve and maintain the required capital levels may be issued a capital directive by the FDIC and/or the DBO to ensure the maintenance of required capital levels. Federal law requires, among other things, that federal bank regulators take “prompt corrective action” with respect to depository institutions that do not meet minimum capital requirements. For this purpose, the law establishes five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. At each successive lower capital category, an insured depository institution is subject to more restrictions and prohibitions, including restrictions on growth, restrictions on interest rates paid on deposits, restrictions or prohibitions on payment of dividends, and restrictions on the acceptance of brokered deposits. Furthermore, if an insured depository institution is classified in one of the undercapitalized categories, it is required to submit a capital restoration plan to the appropriate federal banking agency, and the holding company and any other company deemed to control the bank must guarantee the performance of that plan. Under current regulations, a depository institution is deemed to be “well capitalized” if it has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, a leverage ratio of 5.0% or greater and a common equity Tier 1 ratio of 6.5% or greater. At December 31, 2017, the Bank met the criteria for being considered “well capitalized.”

The FRB has adopted final amendments to the Small Bank Holding Company Policy Statement (Regulation Y, Appendix C) (the “Policy Statement”) that, among other things, raised from $500 million to $1 billion the asset threshold to qualify for the Policy Statement. The Company qualifies for treatment under the Policy Statement and is not currently subject to consolidated capital rules at the bank holding company level.

For additional information, see “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Capital Standards.”

Dividends. The Company's ability to pay cash dividends is dependent on dividends paid to it by the Bank and limited by California corporation law. Under California law, the holders of common stock of the Company are entitled to receive dividends when and as declared by the Board of Directors, out of funds legally available, subject to certain restrictions. The California general corporation law permits a California corporation such as the Company to make a distribution to its shareholders if its retained earnings equal at least the amount of the proposed distribution or if after giving effect to the distribution, the value of the corporation’s assets exceed the amount of its liabilities plus the amount of shareholders preferences, if any, and certain other conditions are met.

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It is the Federal Reserve's policy that bank holding companies should generally pay dividends on common stock only out of income available over the past year, and only if prospective earnings support the organization's expected future needs and financial condition. Further, it is the FRB's policy that bank holding companies should not maintain dividend levels that undermine their ability to be a source of strength to its banking subsidiaries. The Federal Reserve also discourages dividend payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong.

In addition the Company's ability to pay dividends is subject to certain covenants contained in the indentures relating to the trust preferred securities issued by the Company's business trust subsidiaries.

The Bank is a legal entity that is separate and distinct from its holding company. The Company is dependent on the performance of the Bank for funds which may be received as dividends from the Bank for use in the operation of the Company and the ability of the Company to pay dividends to shareholders. Future cash dividends by the Bank will also depend upon management's assessment of future capital requirements, contractual restrictions, and other factors.

Dividends from the Bank to the Company are restricted under California law to the lesser of the Bank's retained earnings or the Bank's net income for the latest three fiscal years, less dividends previously declared during that period, or, with the approval of the DBO, to the greater of the retained earnings of the Bank, the net income of the Bank for its last fiscal year, or the net income of the Bank for its current fiscal year. As of December 31, 2017, the maximum amount available for dividend distribution under this restriction was approximately $11.3 million.

Loans-to-One Borrower. Under California law, the Bank's ability to make aggregate secured and unsecured loans-to-one-borrower is limited to 25% and 15%, respectively, of unimpaired capital and surplus. At December 31, 2017, the Bank's limit on aggregate secured loans-to-one-borrower was $17.9 million and unsecured loans-to-one borrower was $10.7 million. The Bank has established internal loan limits that are lower than the legal lending limits for a California bank.

The Community Reinvestment Act. The Community Reinvestment Act ("CRA") requires that, in connection with examinations of financial institutions within its jurisdiction, the FDIC evaluate the record of the financial institutions in meeting the credit needs of their local communities, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of those institutions. These factors are also considered in evaluating mergers, acquisitions and applications to open a branch or new facility. A less than "Satisfactory" rating would likely result in the suspension of any growth of the Bank through acquisitions or opening de novo branches until the rating is improved. As of the most recent report of examination the Bank's CRA rating was "Satisfactory."

Transactions with Affiliates. Banks are also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal shareholders (including the Company) or any related interest of such persons. Extensions of credit must be made on substantially the same terms, including interest rates and collateral as, and follow credit underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions with persons not affiliated with the bank, and must not involve more than the normal risk of repayment or present other unfavorable features. Banks are also subject to certain lending limits and restrictions on overdrafts to such persons. A violation of these restrictions may result in the assessment of substantial civil monetary penalties on the affected bank or any officer, director, employee, agent or other person participating in the conduct of the affairs of that bank, the imposition of a cease and desist order, and other regulatory sanctions.

The Federal Reserve Act and the FRB's Regulation W limit the amount of certain loan and investment transactions between the Bank and its affiliates, require certain levels of collateral for such loans, and limit the amount of advances to third parties that may be collateralized by the securities of the Company or its subsidiaries. Regulation W requires that certain transactions between the Bank and its affiliates be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving nonaffiliated companies or, in the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to or would apply to nonaffiliated companies. The Company and its subsidiaries have adopted an Affiliate Transactions Policy and have entered into various affiliate agreements in compliance with Regulation W.

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Safety and Soundness Standards. The FRB and the FDIC have adopted non-capital safety and soundness standards for institutions. These standards cover internal controls, information and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, and standards for asset quality, earnings and stock valuation. An institution that fails to meet these standards must develop a plan acceptable to the agency, specifying the steps that it will take to meet the standards. Failure to submit or implement such a plan may subject the institution to regulatory sanctions.

Federal Deposit Insurance. In addition to supervising and regulating state chartered non-member banks, the FDIC insures the Bank's deposits, up to prescribed statutory limits, through the Deposit Insurance Fund (the "DIF"), currently $250,000 per depositor per institution. The DIF is funded primarily by FDIC assessments paid by each DIF member institution. The amount of FDIC assessments paid by each DIF member institution is based on its relative risk of default as measured by regulatory capital ratios and other supervisory factors. The Bank's FDIC insurance expense totaled $255 thousand for 2016.

Additionally, all FDIC-insured institutions are required to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation ("FICO"), an agency of the Federal government established to recapitalize the predecessor to the DIF. The Bank's FICO assessments totaled $30 thousand for 2016. These assessments will continue until the FICO bonds mature in 2017 through 2019.

The FDIC may terminate a depository institution's deposit insurance upon a finding that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices that pose a risk to the DIF or that may prejudice the interest of the bank's depositors. Under California law, the termination of the Bank's deposit insurance would result in a termination of the Bank's charter.

Interstate Branching. The Dodd-Frank Act authorized national and state banks to establish branches in other states to the same extent as a bank chartered by that state would be permitted to branch. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in that state. Accordingly, banks may now enter new markets more freely.

Consumer Protection Laws and Regulations. The banking regulatory agencies are focusing greater attention on compliance with consumer protection laws and their implementing regulations. Examination and enforcement have become more intense in nature, and insured institutions have been advised to monitor carefully compliance with such laws and regulations. The Company is subject to many federal and state consumer protection and privacy statutes and regulations, including but not limited to the following:

The Equal Credit Opportunity Act generally prohibits discrimination in any credit transaction, whether for consumer or business purposes, on the basis of race, color, religion, national origin, sex, marital status, age (except in limited circumstances), receipt of income from public assistance programs, or good faith exercise of any rights under the Consumer Credit Protection Act.

The Truth in Lending Act ("TILA") is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably. As a result of the TILA, all creditors must use the same credit terminology to express rates and payments, including the annual percentage rate, the finance charge, the amount financed, the total of payments and the payment schedule, among other things. As a result of the Dodd-Frank Act, Regulation Z promulgated under the TILA includes new limits on loan originator compensation for all closed-end mortgages. These changes include, prohibiting certain payments to a mortgage broker or loan officer based on the transaction's terms or conditions, prohibiting dual compensation, and prohibiting a mortgage broker or loan officer from ''steering'' consumers to transactions not in their interest, to increase mortgage broker or loan officer compensation.

The Fair Housing Act ("FH Act") regulates many practices, including making it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status. A number of lending practices have been found by the courts to be, or may be considered, illegal under the FH Act, including some that are not specifically mentioned in the FH Act itself.

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The Home Mortgage Disclosure Act (“HMDA”), in response to public concern over credit shortages in certain urban neighborhoods, requires public disclosure of information that shows whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. The HMDA also includes a “fair lending” aspect that requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes.

The Right to Financial Privacy Act imposes a new requirement for financial institutions to provide new privacy protections to consumers. Financial institutions must provide disclosures to consumers of its privacy policy, and state the rights of consumers to direct their financial institution not to share their nonpublic personal information with third parties.

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

Penalties for noncompliance or violations under the above laws may include fines, reimbursement and other penalties. Due to heightened regulatory expectations related to compliance generally, the Company may incur additional compliance costs.

The Dodd-Frank Act created the CFPB as a new, independent federal agency. The CFPB has broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions, including the Bank, are generally subject to rules promulgated by the CFPB but will continue to be examined and supervised by federal banking regulators for consumer compliance purposes.

Anti-Money Laundering Laws. A series of banking laws and regulations beginning with the bank Secrecy Act in 1970 requires banks to prevent, detect, and report illicit or illegal financial activities to the federal government to prevent money laundering, international drug trafficking, and terrorism. Under the US PATRIOT Act of 2001, financial institutions are subject to prohibitions against specified financial transactions and account relationships, requirements regarding the Customer Identification Program, as well as enhanced due diligence and “know your customer” standards in their dealings with high risk customers, foreign financial institutions, and foreign individuals and entities.

Privacy and Data Security. The Gramm-Leach Bliley Act (“GLBA”) of 1999 imposes requirements on financial institutions with respect to consumer privacy. The GLBA generally prohibits disclosure of consumer information to non-affiliated third parties unless the consumer has been given the opportunity to object and has not objected to such disclosure. Financial institutions are further required to disclose their privacy policies to consumers annually. The GLBA also directs federal regulators, including the FDIC, to prescribe standards for the security of consumer information. The Bank is subject to such standards, as well as standards for notifying consumers in the event of a security breach. The Bank is required to have an information security program to safeguard the confidentiality and security of customer information and to ensure proper disposal of information that is no longer needed. Customers must be notified when unauthorized disclosure involves sensitive customer information that may be misused.

Potential Enforcement Actions; Supervisory Agreements. Under federal law, the Bank and its institution-affiliated parties may be the subject of potential enforcement actions by the FDIC for unsafe and unsound practices in conducting their businesses, or for violations of any law, rule or regulation or provision, any consent order with any agency, any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include the imposition of a conservator or receiver, cease-and-desist orders and written agreements, the termination of insurance of deposits, the imposition of civil money penalties, the payment of restitution and removal and prohibition orders against institution-affiliated parties. The DBO also has authority to bring similar enforcement actions against the Bank. The FRB has the authority to bring similar enforcement actions against the Company.

Legislation and Proposed Changes. From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial institutions. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial institutions are frequently made in Congress, in the California legislature and before various bank regulatory agencies. Typically, the intent of this type of legislation is to strengthen the banking industry, even if it may on occasion prove to be a burden on management’s plans. No prediction can be made as to the likelihood of any major changes or the impact that new laws or regulations might have on us.

Effects of Government Monetary Policy. Our earnings and growth are affected not only by general economic conditions, but also by the fiscal and monetary policies of the federal government, particularly the FRB. The FRB implements national monetary policy for such purposes as curbing inflation and combating recession, through its open market operations in U.S. Government securities, control of the discount rate applicable to borrowings from the FRB, and establishment of reserve requirements against certain deposits. These activities influence growth of bank loans, investments and deposits, and also affect interest rates charged on loans or paid on deposits. The Company's profitability, like most financial institutions, is primarily dependent on interest rate spreads. In general, the difference between the interest rates paid by the Bank on interest-bearing liabilities, such as deposits and other borrowings, and the interest rates received by the Bank on interest-earning assets, such as loans extended to customers and securities held in the investment portfolio, will comprise the major portion of the Company's earnings. These rates are highly sensitive to many factors that are beyond our control, such as inflation, recession and unemployment, the monetary and fiscal policies of the federal government and the policies of regulatory agencies, particularly the FRB and the impact which future changes in domestic and foreign economic conditions might have on us cannot be predicted. The nature and impact of future changes in monetary policies and their impact on us cannot be predicted with certainty.

Recent Accounting Pronouncements

See Note 2 – "Summary of Significant Accounting Policies – Adoption of New Accounting Standards" of the Company's Consolidated Financial Statements in Item 8 – Financial Statements and Supplementary Data of this Annual Report on Form 10K for information related to recent accounting pronouncements.

ITEM 1A. RISK FACTORS

A deterioration of national or local economic conditions could reduce the Company's profitability.

The Company's lending operations and its customers are primarily located in the eastern region of Northern California. A significant downturn in the national economy or the local economy due to agricultural commodity prices, real estate prices, public policy decisions, natural disaster, drought or other factors could result in a decline in the local economy in general, which could in turn negatively impact the Company.

The majority of the Company's assets are loans, which if not repaid would result in losses to the Bank.

The Bank, like other lenders, is subject to credit risk, which is the risk of losing principal or interest due to borrowers' failure to repay loans in accordance with their terms. Underwriting and documentation controls cannot mitigate all credit risk. A downturn in the economy or the real estate market in the Company's market areas or a rapid increase in interest rates could have a negative effect on collateral values and borrowers' ability to repay. To the extent loans are not paid timely by borrowers, the loans are placed on non-accrual status, thereby reducing interest income. Further, under these circumstances, an additional provision for loan and lease losses or unfunded commitments may be required. See Management's Discussion and Analysis of Financial Condition and Results of Operations – "Analysis of Asset Quality and Allowance for Loan Losses".

If the Company's allowance for loan losses is not sufficient to absorb actual loan losses, the Company's profitability could be reduced.

The risk of loan losses is inherent in the lending business. The Company maintains an allowance for loan losses based upon the Company's actual losses over a relevant time period and management's assessment of all relevant qualitative factors that may cause future loss experience to differ from its historical loss experience. Although the Company maintains a rigorous process for determining the allowance for loan losses, it can give no assurance that it will be sufficient to cover future loan losses. If the allowance for loan losses is not adequate to absorb future losses, or if bank regulatory agencies require the Company to increase its allowance for loan losses, earnings could be significantly and adversely impacted.

A deterioration in the real estate market could have a material adverse effect on the Company's business, financial condition and results of operations.

As of December 31, 2017, approximately 72% of the Company's total loan portfolio is secured by real estate, the majority of which is commercial real estate. Increases in commercial and consumer delinquency levels or declines in real estate market values would require increased net charge-offs and increases in the allowance for loan losses, which could have a material adverse effect on the Company's business, financial condition and results of operations and prospects.

Fluctuations in interest rates could reduce profitability.

The Company's earnings depend largely upon net interest income, which is the difference between the total interest income earned on interest earning assets (primarily loans and investment securities) and the total interest expense incurred on interest bearing liabilities (primarily deposits and borrowed funds). The interest earned on assets and paid on liabilities are affected principally by direct competition, and general economic conditions at the state and national level and other factors beyond the Company's control such as actions of the FRB, the general supply of money in the economy, legislative tax policies, governmental budgetary matters, and other state and federal economic policies. Although the Company maintains a rigorous process for managing the impact of possible interest rate fluctuations on earnings, the Company can provide no assurance that its management efforts will prevent earnings from being significantly and adversely impacted by changes in interest rates.

The Company could be required to raise additional capital in the future, but that capital may not be available when it is needed or may not be available on terms that are favorable to the Company.

Federal and state bank regulatory authorities require the Company and the Bank to maintain adequate levels of capital to support their operations. The Company's ability to raise additional capital if and as needed depends on conditions in the capital markets, which are outside the Company's control, and on the Company's financial performance. Accordingly, the Company may not be able to raise additional capital, if needed, on terms that are acceptable to the Company. If the Company is unable to raise additional capital when needed, it could be required to curtail its growth strategy or reduce the levels of assets owned. In addition, although the Company and the Bank are currently well-capitalized under applicable regulatory frameworks, bank regulators are authorized and sometimes required to impose a wide range of requirements, conditions, and restrictions on banks and bank holding companies that fail to maintain adequate capital levels.

Drought conditions in California could have an adverse impact on the Company's business.

In recent years, California has experienced a severe drought. However, during 2016 and the first quarter of 2017 much of California has experienced significant rain. A significant portion of the Company's borrowers are involved in or are dependent on the agricultural industry in California, which requires water. As of December 31, 2017, approximately 12% of the Company's loans were categorized as agricultural loans. As a result of the drought, there have been governmental proposals concerning the distribution or rationing of water. If the amount of water available to agriculture becomes scarcer due to drought or rationing, growers may not be able to continue to produce agricultural products profitably, which could force some out of business. Although many of the Company's customers are not directly involved in agriculture, they could be impacted by difficulties in the agricultural industry because many jobs and businesses in the Company's market areas are related to the production of agricultural products. Therefore, the drought could adversely impact the Company's loan portfolio, business, financial condition and results of operations.

The Company faces substantial competition from larger banks and other financial institutions.

The Company faces substantial competition for deposits and loans. Competition for deposits primarily comes from other commercial banks, savings institutions, thrift and loan associations, money market and mutual funds and other investment alternatives. Competition for loans comes from other commercial banks, savings institutions, credit unions, mortgage banking firms, thrift and loan associations and other financial intermediaries. Larger competitors, by virtue of their larger capital resources, have substantially greater lending limits and marketing resources than the Company. In addition, they have greater resources and may be able to offer longer maturities or lower rates. The Company's competitors may also provide certain services for their customers, including trust and international banking that the Company is only able to offer indirectly through correspondent relationships. Ultimately, competition can reduce the Company's profitability, as well as make it more difficult to increase the size of its loan portfolio and deposit base.

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There are risks associated with the Company’s growth strategy.

During the past two years, the Company completed the purchase and assumption of a branch office in Redding, California, opened a branch office in Reno, Nevada and established loan production offices in Phoenix, Arizona; Seattle, Washington and Klamath Falls, Oregon. The Company may engage in additional acquisition activity and open additional offices in the future to expand the Company’s markets or further its growth strategy. There is no assurance that future acquisitions or offices will be successful. Further, growth may strain the Company’s administrative, managerial, financial and operational resources and increase demands on its systems and controls. If the Company pursues its growth strategy too aggressively, fails to attract qualified personnel, control costs or maintain asset quality, or if factors beyond management’s control divert attention away from its business operations, the Company’s pursuit of its growth strategy could have a material adverse impact on its existing business.

The Company relies on key executives and personnel and the loss of any of them could have a material adverse impact on the Company’s prospects.

Competition for qualified employees and personnel in the banking industry is intense and there are a limited number of qualified persons with knowledge of, and experience in, the California community banking industry. The process of recruiting personnel with the combination of skills and attributes required to carry out the Company’s strategies is often lengthy. The Company’s success depends to a significant degree upon its ability to attract and retain qualified management, loan origination, finance, administrative, marketing, compliance and technical personnel and upon the continued contributions of its management and personnel. In particular, the Company’s success has been and continues to be highly dependent upon the abilities of key executives and certain other employees.

Security breaches and technological disruptions could damage the Company’s reputation and profitability. The Company’s business is highly reliant on third party vendors and its ability to manage the operational risks associated with outsourcing those services.

The Company’s electronic banking activities expose it to possible liability and loss of reputation should an unauthorized party gain access to confidential customer information. Despite its considerable efforts and investment to provide the security and authentication necessary to effect secure transmission of data, the Company cannot fully guarantee that these precautions will protect its systems from future compromises or breaches of its security measures. Although the Company has developed systems and processes that are designed to recognize and assist in preventing security breaches (and periodically test its security), failure to protect against or mitigate breaches of security could adversely affect its ability to offer and grow its online services, constitute a breach of privacy or other laws, result in costly litigation and loss of customer relationships, negatively impact the Bank’s reputation, and could have an adverse effect on its business, results of operations and financial condition. The Company may also incur substantial increases in costs in an effort to minimize or mitigate cyber security risks and to respond to cyber incidents.

The potential for operational risk exposure exists throughout the Company’s business. Integral to the Company’s performance is the continued efficacy of the Company’s technology and information systems, operational infrastructure and relationships with third parties and its colleagues in its day-to-day and ongoing operations. Failure by any or all of these resources subjects us to risks that may vary in size, scale and scope. This includes, but is not limited to, operational or systems failures, disruption of client operations and activities, ineffectiveness or exposure due to interruption in third party support as expected, as well as, the loss of key colleagues or failure on the part of key colleagues to perform properly.

Additionally, the Company outsources a large portion of its data processing to third parties which may encounter technological or other difficulties that may significantly affect the Company’s ability to process and account for customer transactions. These vendors provide services that support its operations, including the storage and processing of sensitive consumer and business customer data, as well as its sales efforts. A cyber security breach of a vendor’s system may result in theft of the Company’s data or disruption of business processes. In most cases, the Company will remain primarily liable to its customers for losses arising from a breach of a vendor’s data security system. The Company relies on its outsourced service providers to implement and maintain prudent cyber security controls. The loss of these vendor relationships could disrupt the services the Company provides to its customers and cause us to incur significant expense in connection with replacing these services.

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The Company may incur fines, penalties and other negative consequences from regulatory violations, possibly even inadvertent or unintentional violations.

The Company is subject to significant federal and state regulation and supervision. In the past, the Company's business has been increasingly affected by these regulations, and this trend is likely to continue into the future. Many of these laws are subject to interpretation and changing regulatory approaches to supervision and enforcement. The Company maintains systems and procedures designed to ensure that it complies with applicable laws and regulations, but there can be no assurance that these will be effective. The Company may incur fines, penalties and other negative consequences from regulatory violations. The Company may also suffer other negative consequences resulting from findings of noncompliance with laws and regulations, that may also damage its reputation, and this in turn might materially affect its business and results of operations. Further, some legal/regulatory frameworks provide for the imposition of fines, restitution or penalties for noncompliance even though the noncompliance was inadvertent or unintentional and even though there were in place at the time systems and procedures designed to ensure compliance.

The Company's disclosure controls and procedures may not prevent or detect all errors or acts of fraud.

The Company's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by us in reports it files under the Exchange Act is accurately accumulated and communicated to management, and recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. The Company believes that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, cannot provide absolute assurance that the objectives of the control system are met.

These inherent limitations include the realities that judgments in decision making can be faulty, that alternative reasoned judgments can be drawn, or that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by an unauthorized override of the controls. Accordingly, because of the inherent limitations in its control system, misstatements due to error or fraud may occur and not be detected, which could result in a material weakness in its internal controls over financial reporting and the restatement of previously filed financial statements.

The price of the Company's common stock may be volatile or may decline

The trading price of the Company's common stock may fluctuate as a result of a number of factors, many of which are outside its control. Among the factors that could affect the Company's stock price are:

- actual or anticipated quarterly fluctuations in the Company's operating results and financial condition;
- research reports and recommendations by financial analysts;
- failure to meet analysts' revenue or earnings estimates;
- speculation in the press or investment community;
- actions by the Company or its competitors, such as acquisitions or restructurings;
- actions by institutional shareholders;
- fluctuations in the stock prices and operating results of its competitors;
- general market conditions and, in particular, developments related to market conditions for the financial services industry;
- proposed or adopted regulatory changes or developments;
- anticipated or pending investigations, proceedings or litigation that involve or affect us;
- domestic and international economic factors unrelated to its performance.

Significant decline in the Company's stock price could result in substantial losses for individual shareholders and could lead to costly and disruptive securities litigation.

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The trading volume of the Company's common stock is limited.

Although the Company's common stock is traded on the Nasdaq Stock Market, trading volume to date has been relatively modest. The limited trading market for the Company's common stock may lead to exaggerated fluctuations in market prices and possible market inefficiencies compared to more actively traded securities. It may also make it more difficult for investors to sell the Company's common stock at desired prices, especially for holders seeking to dispose of a large number of shares of stock.

The Company depends primarily on the operations of the Bank to repay its indebtedness and fund its operations. The Company's ability to pay any dividends or repurchase any of its shares in the future will also depend on the success of the Bank's operations.

The Company is a separate and distinct legal entity from its subsidiary, the Bank, and it receives substantially all of its revenue from dividends paid by the Bank. There are legal limitations on the extent to which the Bank may extend credit, pay dividends or otherwise supply funds to, or engage in transactions with, the Company. The Company's inability to receive dividends from the Bank could adversely affect its business, financial condition, results of operations and prospects.

Disruptions in market conditions may adversely impact the fair value of available-for-sale investment securities.

Generally Accepted Accounting Principles ("GAAP") require the Company to carry its available-for-sale investment securities at fair value on its balance sheet. Unrealized gains or losses on these securities, reflecting the difference between the fair market value and the amortized cost, net of its tax effect, are reported as a component of shareholders' equity. In certain instances GAAP requires recognition through earnings of declines in the fair value of securities that are deemed to be other than temporarily impaired. Changes in the fair value of these securities may result from a number of circumstances that are beyond the Company's control, such as changes in interest rates, the financial condition of government sponsored enterprises or insurers of municipal bonds, changes in demand for these securities as a result of economic conditions, or reduced market liquidity. There can be no assurance that the declines in market value will not result in other than temporary impairments of these assets, which would lead to loss recognition that could have a material adverse effect on the Company's net income and capital levels.

Damage to the Company's reputation could significantly harm the Company's business and prospects.

The Company's reputation is an important asset. The Company's relationship with many of its customers is predicated upon its reputation as a high quality provider of financial services that adheres to the highest standards of ethics, service quality and regulatory compliance. The Company's ability to attract and retain customers, investors and employees depends upon external perceptions. Damage to its reputation among existing and potential customers, investors and employees could cause significant harm to the Company's business and prospects and may arise from numerous sources, including litigation or regulatory actions, failing to deliver minimum standards of service and quality, lending practices, inadequate protection of customer information, sales and marketing efforts, compliance failures, unethical behavior and the misconduct of employees. Adverse developments in the banking industry may also, by association, negatively impact the Company's reputation or result in greater regulatory or legislative scrutiny or litigation against us. The Company has policies and procedures in place that seek to protect its reputation and promote ethical conduct, but these policies and procedures may not be fully effective. Negative publicity regarding the Company's business, employees, or customers, with or without merit, may result in the loss of customers, investors, and employees, costly litigation, a decline in revenues and increased governmental regulation.

The markets in which the Company operates are subject to the risk of earthquakes and other natural disasters.

Most of the Company's offices are located in California. Also, most of the real and personal properties securing the Company's loans are located in California. California is prone to earthquakes, brush fires, flooding and other natural disasters. In addition to possibly sustaining damage to its own properties, if there is a major earthquake, brush fires, flood or other natural disaster, the Company faces the risk that many of the Company's borrowers may experience uninsured property losses, or sustained job interruption and/or loss which may materially impair their ability to meet the terms of their loan obligations. Therefore, a major earthquake, brush fire, flood or other natural disaster in California could have a material adverse effect on the Company's business, financial condition, results of operations and cash flows.

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The Company is exposed to risk of environmental liabilities with respect to real properties that is may acquire.

If the Company's borrowers are unable to meet their loan repayment obligations, it will initiate foreclosure proceedings with respect to and may take actions to acquire title to the personal and real property that collateralized their loans. As an owner of such properties, the Company could become subject to environmental liabilities and incur substantial costs for any property damage, personal injury, investigation and clean-up that may be required due to any environmental contamination that may be found to exist at any of those properties, even though it did not engage in the activities that led to such contamination. In addition, if the Company were the owner or former owner of a contaminated site, it could be subject to common law claims by third parties seeking damages for environmental contamination emanating from the site. If the Company were to become subject to significant environmental liabilities or costs, its business, financial condition, results of operations and prospects could be adversely affected.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

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ITEM 2. PROPERTIES

Of the Company’s twelve depository branches, ten are owned and two are leased. The Company also leases three lending offices and owns four administrative facilities.

Owned Properties

35 South Lindan Avenue Quincy, California (1)	32 Central Avenue Quincy, California (1)	80 W. Main St. Quincy, California (1)
424 N. Mill Creek Quincy, California (1)	336 West Main Street Quincy, California	120 North Pine Street Portola, California
43163 Highway 299E Fall River Mills, California	121 Crescent Street Greenville, California	255 Main Street Chester, California
510 North Main Street Alturas, California	3000 Riverside Drive Susanville, California	8475 North Lake Boulevard Kings Beach, California
11638 Donner Pass Road Truckee, California	5050 Meadowood Mall Circle Reno, Nevada	

Leased Properties

243 North Lake Boulevard Tahoe City, California	1335 Hilltop Drive Redding, California	470 Nevada St., Suite 108 Auburn, California (2)
100 Amber Grove Dr., Suite 105 Chico, CA (3)	107 S. 7th St. (3) Klamath Falls, OR	

(1) Non-branch administrative or credit administrative offices.

(2) SBA lending office.

(3) Commercial lending office.

Total rental expenses under all leases totaled $308,000, $276,000 and $233,000, in 2017, 2016 and 2015 respectively. The expiration dates of the leases vary, with the first such lease expiring during 2018 and the last such lease expiring during 2021.

Future minimum lease payments are as follows:

Year Ending December 31,	
2018	$308,000
2019	289,000
2020	202,000
2021	91,000
2022	-
	$890,000

The Company maintains insurance coverage on its premises, leaseholds and equipment, including business interruption and record reconstruction coverage. The branch properties and non-branch offices are adequate, suitable, in good condition and have adequate parking facilities for customers and employees. The Company and Bank are limited in their investments in real property under Federal and state banking laws. Generally, investments in real property are either for the Company and Bank use or are in real property and real property interests in the ordinary course of the Bank's business.

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ITEM 3. 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 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCK- HOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

The Company's common stock is quoted on the NASDAQ Capital Market under the ticker symbol "PLBC". As of December 31, 2017, there were 5,064,972 shares of the Company's common stock outstanding held by approximately 1,500 shareholders of record as of the same date. The following table shows the high and low sales prices for the common stock, for each quarter as reported by Yahoo Finance.

Quarter	Common Dividends per share	High	Low
4th Quarter 2017	$ 0.14	$23.35	$20.35
3rd Quarter 2017	-	$21.75	$19.10
2nd Quarter 2017	0.14	$22.00	$17.50
1st Quarter 2017	-	$19.50	$15.85
4th Quarter 2016	$ 0.10	$19.23	$10.00
3rd Quarter 2016	-	$10.39	$8.75
2nd Quarter 2016	-	$9.75	$8.60
1st Quarter 2016	-	$9.46	$8.20

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 and in accordance with regulatory restrictions, if any, reviews the appropriateness of a cash dividend payment. 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 to shareholders of record at the close of business day on November 7, 2016. On April 19, 2017 the Company declared a semi-annual cash dividend totaling $0.14 per share which was paid on May 15, 2017 to shareholders of record at the close of business day on May 1, 2017. On October 18, 2017 the Company declared a semi-annual cash dividend totaling $0.14 per share which was paid on November 15, 2017 to shareholders of record at the close of business day on November 1, 2017.

The Company is subject to various restrictions on the payment of dividends. See Note 12 "Shareholders' Equity – Dividend Restrictions" of the Company's Consolidated Financial Statements in Item 8 – Financial Statements and Supplementary Data of this Annual Report on Form 10K.

Securities Authorized for Issuance under Equity Compensation Plans. The following table sets forth securities authorized for issuance under equity compensation plans as of December 31, 2017.

Plan Category	Number of securities to be issued upon exercise of outstanding options	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	206,893	$ 6.65	305,600
Equity compensation plans not approved by security holders	None	Not Applicable	None
Total	206,893	$ 6.65	305,600

For additional information related to the above plans see Note 12 of the Company's Consolidated Financial Statements in Item 8 – Financial Statements and Supplementary Data of this Annual Report on Form 10K.

Issuer Purchases of Equity Securities. There were no purchases of Plumas Bancorp common stock by the Company during 2017 or 2016.

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ITEM 6. SELECTED FINANCIAL DATA

The following table presents a summary of selected financial data and should be read in conjunction with the Company's consolidated financial statements and notes thereto included under Item 8 – Financial Statements and Supplementary Data.

	At or for the year ended December 31,				
	2017	**2016**	**2015**	**2014**	**2013**
	(dollars in thousands except per share information)				
Statement of Income					
Interest income	$28,953	$25,100	$22,615	$21,147	$19,460
Interest expense	1,017	1,023	1,204	1,693	1,534
Net interest income	27,936	24,077	21,411	19,454	17,926
Provision for loan losses	600	800	1,100	1,100	1,400
Noninterest income	8,280	7,652	7,715	7,315	6,642
Noninterest expense	20,111	18,696	18,491	17,845	17,570
Provision for income taxes	7,316	4,759	3,717	3,086	2,167
Net income	$8,189	$7,474	$5,818	$4,738	$3,431
Discount on redemption of Preferred Stock	$-	$-	$-	$-	$565
Preferred Stock dividends and discount accretion	-	-	-	-	347
Net income available to common shareholders	$8,189	$7,474	$5,818	$4,738	$3,649
Balance sheet (end of period)					
Total assets	$745,427	$657,975	$599,286	$538,862	$515,725
Total loans	$486,634	$461,123	$400,971	$370,390	$338,551
Allowance for loan losses	$6,669	$6,549	$6,078	$5,451	$5,517
Total deposits	$662,657	$582,353	$527,276	$467,891	$449,439
Total shareholders' equity	$55,700	$47,994	$42,496	$36,497	$30,593
Balance sheet (period average)					
Total assets	$695,320	$622,229	$571,990	$531,528	$497,711
Total loans	$471,747	$428,380	$386,070	$353,389	$321,210
Total deposits	$617,211	$549,416	$503,343	$464,067	$432,284
Total shareholders' equity	$53,251	$46,488	$39,844	$33,810	$36,032
Asset quality ratios					
Nonperforming loans/total loans	0.62 %	0.59 %	1.13 %	1.79 %	1.64 %
Nonperforming assets/total assets	0.59 %	0.53 %	1.06 %	1.90 %	2.33 %
Allowance for loan losses/total loans	1.37 %	1.42 %	1.52 %	1.47 %	1.63 %
Net loan charge-offs	$480	$329	$473	$1,166	$1,569
Performance ratios					
Return on average assets	1.18 %	1.20 %	1.02 %	0.89 %	0.69 %
Return on average equity	15.4 %	16.1 %	14.6 %	14.0 %	9.5 %
Net interest margin	4.35 %	4.21 %	4.10 %	4.05 %	4.03 %
Loans to deposits	73.4 %	79.2 %	76.0 %	79.2 %	75.3 %

Efficiency ratio	55.5 %	58.9 %	63.5 %	66.7 %	71.5 %
Per share information					
Basic earnings	$1.64	$1.54	$1.21	$0.99	$0.76
Diluted earnings	$1.58	$1.47	$1.15	$0.95	$0.75
Common cash dividends	$0.28	$0.10	$0.00	$0.00	$0.00
Book value per common share	$11.00	$9.80	$8.79	$7.61	$6.39
Common shares outstanding at period end	5,064,972	4,896,875	4,835,432	4,799,139	4,787,739
Capital ratios – Plumas Bank					
Leverage ratio	8.8 %	9.2 %	9.4 %	9.8 %	9.7 %
Tier 1 risk-based capital	12.0 %	12.1 %	12.7 %	13.2 %	13.2 %
Total risk-based capital	13.2 %	13.3 %	14.0 %	14.4 %	14.5 %

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

General

We are a bank holding company for Plumas Bank, a California state-chartered commercial bank. We derive our income primarily from interest received on real estate related, commercial, automobile and consumer loans and, to a lesser extent, interest on investment securities, fees received in connection with servicing deposit and loan customers and gains from the sale of government guaranteed loans. Our major operating expenses are the interest we pay on deposits and borrowings and general operating expenses. We rely on locally-generated deposits to provide us with funds for making loans.

We are subject to competition from other financial institutions and our operating results, like those of other financial institutions operating in California, are significantly influenced by economic conditions in California, including the strength of the real estate market. In addition, both the fiscal and regulatory policies of the federal and state government and regulatory authorities that govern financial institutions and market interest rates also impact the Bank's financial condition, results of operations and cash flows.

Critical Accounting Policies

Our accounting policies are integral to understanding the financial results reported. Our most complex accounting policies require management's judgment to ascertain the valuation of assets, liabilities, commitments and contingencies. We have established detailed policies and internal control procedures that are intended to ensure valuation methods are applied in an environment that is designed and operating effectively and applied consistently from period to period. The following is a brief description of our current accounting policies involving significant management valuation judgments.

Allowance for Loan Losses. The allowance for loan losses is an estimate of credit losses inherent in the Company's loan portfolio that have been incurred as of the balance-sheet date. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired loans and general reserves for inherent losses related to loans that are collectively evaluated for impairment.

We evaluate our allowance for loan losses quarterly. We believe that the allowance for loan losses is a “critical accounting estimate” because it is based upon management’s assessment of various factors affecting the collectability of the loans, including current economic conditions, past credit experience, delinquency status, the value of the underlying collateral, if any, and a continuing review of the portfolio of loans.

We cannot provide you with any assurance that economic difficulties or other circumstances which would adversely affect our borrowers and their ability to repay outstanding loans will not occur which would be reflected in increased losses in our loan portfolio, which could result in actual losses that exceed reserves previously established.

Other Real Estate Owned. Other real estate owned (OREO) represents properties acquired through foreclosure or physical possession. OREO is initially recorded at fair value less costs to sell when acquired. Write-downs to fair value at the time of transfer to OREO are charged to allowance for loan losses. Subsequent to foreclosure, we periodically evaluate the value of OREO held for sale and record a valuation allowance for any subsequent declines in fair value less selling costs. Subsequent declines in value are charged to operations. Fair value is based on our assessment of information available to us at the end of a reporting period and depends upon a number of factors, including our historical experience, economic conditions, and issues specific to individual properties. Our evaluation of these factors involves subjective estimates and judgments that may change.

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The following discussion is designed to provide a better understanding of significant trends related to the Company's financial condition, results of operations, liquidity and capital. It pertains to the Company's financial condition, changes in financial condition and results of operations as of December 31, 2017 and 2016 and for each of the three years in the period ended December 31, 2017. The discussion should be read in conjunction with the Company's audited consolidated financial statements and notes thereto and the other financial information appearing elsewhere herein.

Overview

The Company recorded net income of $8.2 million for the year ended December 31, 2017, an increase of $715 thousand or 10% over net income of $7.5 million during the year ended December 31, 2016. Pretax income increased by $3.3 million, or 27%, to $15.5 million in 2017 from $12.2 million during the year ended December 31, 2016.

On December 22, 2017, the Tax Cuts and Jobs Act (the “TCJ Act”) was enacted into law. The TCJ Act provides for significant changes to the U.S. Internal Revenue Code of 1986, as amended (the “Code”), that impact corporate taxation requirements, such as the reduction of the top federal tax rate for corporations from 35% to 21% and changes or limitations to certain tax deductions.

The reduction in the corporate tax rate under the TCJ Act required a one-time revaluation of certain tax-related assets to reflect their value at the lower corporate tax rate of 21%. As such, the Company has recorded a reduction in the value of these assets of $1.4 million, which relates to the Company’s net deferred tax assets. Solely based on this reduction in certain tax assets, the Company recorded an additional provision for income taxes of $1.4 million, or $0.27 per diluted share, in its income statement for the fourth quarter of 2017.

Net interest income increased by $3.8 million to $27.9 million during 2017 from $24.1 million for the year ended December 31, 2016. This increase in net interest income resulted from an increase in interest income of $3.8 million and a decrease in interest expense of $6 thousand. Interest on loans increased by $2.9 million, interest on investment securities increased by $581 thousand and interest on other interest earning assets increased by $400 thousand. The provision for loan losses was $600 thousand during 2017 down $200 thousand from $800 thousand during 2016.

During the year ended December 31, 2017 non-interest income totaled $8.3 million an increase of $628 thousand from the $7.7 million earned during 2016. Non-interest expense increased by $1.4 million to $20.1 million during the twelve months ended December 31, 2017. The largest component of the increase in non-interest expense was an increase in salary and benefit expense of $1.1 million.

The provision for income taxes increased by $2.5 million from $4.8 million in 2016 to $7.3 million during the year ended December 31, 2017.

Total assets at December 31, 2017 were $745 million, an increase of $87.5 million from $658 million at December 31, 2016. This increase included increases of $24.9 million in cash and due from banks, $35.9 million in investment securities, $25.7 million in net loans ($25.5 million in gross loans), $0.3 million in bank owned life insurance, $0.6 million in OREO and $0.5 million in other assets exclusive of OREO. These items were partially offset by a decrease of $0.4 million in premises and equipment.

Gross loan balances increased by $25.5 million, or 5.5%, from $461 million at December 31, 2016 to $487 million at December 31, 2017. The increase in loan balances includes $14.1 million in commercial real estate loans, $7.8 million in agricultural loans, $3.3 million in construction and land development loans and $6.9 million in automobile loans. These increases were partially offset by declines in other loan categories the largest of which was a decrease of $4.7 million in residential real estate loans.

Total deposits increased by $80.3 million, or 14%, from $582.4 million at December 31, 2016 to $662.7 million at December 31, 2017. At December 31, 2017, 43% of the Company’s deposits were in the form of non-interest bearing demand deposits. Core deposit growth remained strong in 2017 as evidenced by increases of $45.5 million in demand deposits, $27.0 million in savings accounts, $3.5 million in money market accounts and $7.9 million in interest bearing transaction accounts. Time deposits declined by $3.6 million, much of which we attribute to migration into other types of deposits given the low rates and lack of liquidity associated with time deposits. The Company has no brokered deposits.

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Total shareholders’ equity increased by $7.7 million from $48.0 million at December 31, 2016 to $55.7 million at December 31, 2017. The $7.7 million includes earnings during the twelve month period totaling $8.2 million, a decrease in the net unrealized loss on investment securities of $0.4 million; stock option activity totaling $0.4 million and a $0.1 million reclassification from accumulated other comprehensive loss to retained earnings. These items were partially offset by the payment of two $0.14 semi-annual cash dividends totaling $1.4 million.

The return on average assets was 1.18% for 2017, down from 1.20% for 2016. The return on average equity was 15.4% for 2017, down from 16.1% for 2016.

Results of Operations

Net Interest Income

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

	Year ended December 31, 2017			2016			2015		
	Average balance	Interest income/ expense	Rates earned/ paid	Average balance	Interest income/ expense	Rates earned/ paid	Average balance	Interest income/ expense	Rates earned/ paid
	(dollars in thousands)								
Assets									
Interest bearing deposits	$56,524	$674	1.19 %	$43,843	$274	0.62 %	$44,302	$174	0.39 %
Investment securities[1]	114,477	2,479	2.17	99,689	1,898	1.90	91,309	1,694	1.86
Total loans [2][3]	471,747	25,800	5.47	428,380	22,928	5.35	386,070	20,747	5.37
Total earning assets	642,748	28,953	4.50 %	571,912	25,100	4.39 %	521,681	22,615	4.34 %
Cash and due from banks	19,531			17,494			17,332		
Other assets	33,041			32,823			32,977		

Total assets	$695,320				$622,229				$571,990			
Liabilities and shareholders' equity												
Interest bearing demand deposits	$96,945	89	0.09	%	$92,481	85	0.09	%	$88,220	80	0.09	%
Money market deposits	58,594	84	0.14		54,559	78	0.14		47,149	66	0.14	
Savings deposits	159,707	264	0.17		133,304	217	0.16		119,071	191	0.16	
Time deposits	47,360	145	0.31		50,788	157	0.31		54,418	181	0.33	
Note payable	700	28	4.00		3,289	133	4.04		3,858	155	4.02	
Subordinated debentures	-	-	-		-	-	-		2,150	219	10.19	
Junior subordinated debentures	10,310	401	3.89		10,310	348	3.38		10,310	306	2.97	
Other	7,421	6	0.08		6,423	5	0.08		6,529	6	0.09	
Total interest bearing liabilities	381,037	1,017	0.27	%	351,154	1,023	0.29	%	331,705	1,204	0.36	%
Noninterest bearing demand deposits	254,605				218,284				194,485			
Other liabilities	6,427				6,303				5,956			
Shareholders' equity	53,251				46,488				39,844			
Total liabilities and shareholders' equity	$695,320				$622,229				$571,990			
Net interest income		$27,936				$24,077				$21,411		
Net interest spread (4)			4.23	%			4.10	%			3.98	%
Net interest margin (5)			4.35	%			4.21	%			4.10	%

(1) Interest income is reflected on an actual basis and is not computed on a tax-equivalent basis.

(2) Average nonaccrual loan balances of $3.2 million for 2017, $3.8 million for 2016 and $5.6 million for 2015 are included in average loan balances for computational purposes.

(3) Loan origination fees and costs are included in interest income as adjustments of the loan yields over the life of the loan using the interest method. Loan interest income includes net loan costs of $501,000, $678,000 and $696,000 for 2017, 2016 and 2015, respectively.

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

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

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The following table sets forth changes in interest income and interest expense, for the years 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:

	2017 compared to 2016				**2016 compared to 2015**			
	Increase (decrease) due to change in:				**Increase (decrease) due to change in:**			
	Average Volume(1)	**Average Rate(2)**	**Mix(3)**	**Total**	**Average Volume(1)**	**Average Rate(2)**	**Mix(3)**	**Total**
	(dollars in thousands)							
Interest-earning assets:								
Interest bearing deposits	$79	$ 249	$ 72	$400	$(2)	$ 103	$ (1)	$100
Investment securities	282	261	38	581	156	44	4	204
Loans	2,321	500	51	2,872	2,274	(84)	(9)	2,181
Total interest income	2,682	1,010	161	3,853	2,428	63	(6)	2,485
Interest-bearing liabilities:								
Interest bearing demand deposits	4	-	-	4	4	1	-	5
Money market deposits	6	-	-	6	11	1	-	12
Savings deposits	43	3	1	47	23	3	-	26
Time deposits	(11)	(1)	-	(12)	(12)	(13)	1	(24)
Note payable	(105)	(1)	1	(105)	(23)	1	-	(22)
Subordinated debentures	-	-	-	-	(219)	-	-	(219)
Junior subordinated debentures	-	53	-	53	-	42	-	42
Other borrowings	1	-	-	1	-	(1)	-	(1)
Total interest expense	(62)	54	2	(6)	(216)	34	1	(181)
Net interest income	$2,744	$ 956	$ 159	$3,859	$2,644	$ 29	$ (7)	$2,666

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

2017 compared to 2016. Net interest income is the difference between interest income and interest expense. Net interest income, on a nontax-equivalent basis, was $27.9 million for the year ended December 31, 2017, up $3.8 million, or 16%, from $24.1 million for 2016. The $3.8 million included an increase of $3.8 million, or 15.4%, in interest income, from $25.1 million during 2016 to $28.9 million during the current year and a decrease of $6 thousand in interest expense.

Interest and fees on loans increased by $2.9 million, interest on investment securities increased by $581 thousand and interest on deposits increased by $400 thousand. These increases include both an increase in average balance and an increase in average yield.

Interest and fees on loans was $25.8 million during 2017. The average loan balances were $471.7 million for 2017, up $43.3 million from the $428.4 million during 2016. The following table compares loan balances by type at December 31, 2017 and 2016.

(dollars in thousands)	**Balance at End of Period 12/31/17**	**Percent of Loans in Each Category to Total Loans 12/31/17**		**Balance at End of Period 12/31/16**	**Percent of Loans in Each Category to Total Loans 12/31/16**	
Commercial	$39,620	8.1	%	$41,293	9.0	%
Agricultural	58,908	12.1	%	51,103	11.1	%
Real estate – residential	16,624	3.4	%	21,283	4.6	%
Real estate – commercial	240,257	49.4	%	226,136	49.0	%
Real estate – construction & land development	25,181	5.2	%	21,904	4.7	%
Equity Lines of Credit	41,798	8.6	%	42,338	9.2	%
Auto	60,438	12.4	%	53,553	11.6	%
Other	3,808	0.8	%	3,513	0.8	%
Total Gross Loans	$486,634	100	%	$461,123	100	%

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The average yield on loans was 5.47% for 2017 up 12 basis points from 5.35% for 2016. We attribute much of the increase in yield to an increase in the average prime rate of 59 basis points mostly offset to by price competition in our service area. At December 31, 2017 approximately 30% of the Company’s loan portfolio was comprised of loans tied to the prime rate or an equivalent rate.

Interest on investment securities increased by $581 thousand as a result of an increase in yield of 27 basis points from 1.90% during 2016 to 2.17% during 2017 and an increase in average balance from $99.7 million in 2016 to $114.5 million in 2017. During the current period yield benefited from market conditions and the maturity, sales and payments on lower earning securities. Interest income on interest bearing deposits, which totaled $674 thousand in 2017 and $274 thousand in 2016, primarily relates to interest on cash balances held at the Federal Reserve. The $400 thousand increase in interest on interest bearing deposits was related to an increase in yield of 57 basis points from 62 basis points in 2016 to 119 basis points in 2017; consistent with the increase in the average fed funds rate during these periods. In addition, average interest earning deposits increased by $12.7 million from $43.8 million during 2016 to $56.5 million in 2017.

Interest expense on deposits increased by $45 thousand to $582 thousand for the twelve months ended December 31, 2017, up from $537 thousand in 2016. Interest expense on NOW accounts increased by $4 thousand. Rates paid on NOW accounts averaged 0.09% during 2017 and 2016. Average balances increased by $4.4 million to $96.9 million during 2017 from $92.5 million during 2016. Interest expense on money market accounts increased by $6 thousand to $84 thousand during the year ended December 31, 2017. Rates paid on money market accounts averaged 0.14% during 2017 and 2016. Average balances increased by $4.0 million from $54.6 million in 2016 to $58.6 million during the year ended December 31, 2017. Interest expense on savings accounts increased by $47 thousand as we continued to experience strong growth in this category of deposits. Average savings deposits increased by $26.4 million from $133.3 million during 2016 to $159.7 million during 2017. The average rate paid on savings accounts increased slightly from 16 basis points during 2016 to 17 basis points in 2017.

Interest expense on time deposits declined by $12 thousand from $157 thousand during 2016 to $145 thousand during 2017. Average time deposits declined by $3.4 million from $50.8 million during 2016 to $47.4 million during the year ended December 31, 2017. We attribute much of this decline to migration into other types of deposits given the low rates and lack of liquidity associated with time deposits. The average rate paid on time deposits was 0.31% during both 2016 and 2017.

Interest expense on other interest-bearing liabilities decreased by $51 thousand from $486 thousand during the year ended December 31, 2016 to $435 thousand during the current twelve month period. Interest expense on the Company’s note payable decreased by $105 thousand to $28 thousand during the twelve months ended December 31, 2017. This decrease was related to a decrease in average borrowings on this note from $3.3 million during the 2016 to $700 thousand during 2017. The note payable was paid off in April of 2017. Interest expense on junior subordinated debentures, which increased by $53 thousand to $401 thousand, fluctuates with changes in the 3-month London Interbank Offered Rate (LIBOR) rate.

Net interest margin is net interest income expressed as a percentage of average interest-earning assets. As a result of the changes noted above, the net interest margin for 2017 increased to 4.35%, from 4.21% during 2016.

2016 compared to 2015. Net interest income, on a nontax-equivalent basis, was $24.1 million for the year ended December 31, 2016, up $2.7 million, or 12.5%, from $21.4 million for 2015. The $2.7 million included an increase of $2.5 million, or 11.0% in interest income, from $22.6 million during 2015 to $25.1 million during the current year and a decrease of $181 thousand in interest expense.

Interest and fees on loans increased by $2.2 million, interest on investment securities increased by $204 thousand and interest on deposits increased by $100 thousand. The increase in interest and fees on loans was related to an increase in average loan balances partially offset by a decline in yield. Interest on investments securities benefited from both an increase in yield and an increase in average balance.

Interest and fees on loans was $22.9 million during 2016. The average loan balances were $428.4 million for 2016, up $42.3 million from the $386.1 million for 2015. The average yield on loans was 5.35% for 2016 down slightly from 5.37% for 2015. We attribute much of the decrease in yield to price competition in our service area for commercial real estate loans mostly offset by the 25 basis point increase in the prime rate on December 17, 2015.

Interest on investment securities increased by $204 thousand as a result of an increase in yield of 4 basis points from 1.86% during 2015 to 1.90% during 2016 and an increase in average balance from $91.3 million in 2015 to $99.7 million in 2016. Interest income on interest bearing deposits, which totaled $274 thousand in 2016 and $174 thousand in 2015, primarily relates to interest on cash balances held at the Federal Reserve. The $100 thousand increase in interest on interest bearing deposits was related to an increase in yield of 23 basis points from 39 basis points in 2015 to 62 basis points in 2016 and is consistent with the increase in the average fed funds rate during these periods.

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Interest expense on deposits increased by $19 thousand to $537 thousand for the twelve months ended December 31, 2016, up from $518 thousand in 2015. Interest expense on time deposits declined by $24 thousand from $181 thousand during 2015 to $157 thousand during 2016. Average time deposits declined by $3.6 million from $54.4 million during 2015 to $50.8 million during the year ended December 31, 2016. We attribute much of this decline to migration into other types of deposits given the low rates and lack of liquidity associated with time deposits. The average rate paid on time deposits decreased from 0.33% during 2015 to 0.31% during the current twelve month period. This decrease primarily relates to the maturity of higher rate time deposits.

Interest expense on NOW accounts increased by $5 thousand. Rates paid on NOW accounts averaged 0.09% during 2016 and 2015. Average balances increased by $4.3 million from 2015 to $92.5 million. Interest expense on money market accounts increased by $12 thousand to $78 thousand during the year ended December 31, 2016. Rates paid on money market accounts averaged 0.14% during 2016 and 2015. Average balances increased by $7.4 million from $47.2 million in 2015 to $54.6 million. Interest expense on savings accounts increased by $26 thousand as we continued to experience strong growth in this category of deposits. Average savings deposits increased by $14.2 million from $119.1 million during 2015 to $133.3 million during 2016. The average rate paid on savings accounts during these same periods was 16 basis points.

Interest expense on other interest-bearing liabilities decreased by $200 thousand from $686 thousand during the year ended December 31, 2015 to $486 thousand during the current twelve month period. On April 15, 2013, to help fund the repurchase of preferred stock during 2013, the Company issued a $7.5 million subordinated debenture. On April 16, 2015 we paid off the subordinated debenture resulting in a reduction in interest expense related to this debt of $219 thousand.

Interest expense on the Company's note payable decreased by $22 thousand to $133 thousand during the twelve months ended December 31, 2016. This decrease was related to a decrease in average borrowings on this note from $3.9 million during the 2015 period to $3.3 million during the year ended December 31, 2016. The average rate paid on the note payable was 4.04% during 2016 and 4.02% during the twelve months ended December 31, 2015.

Interest expense on junior subordinated debentures, which increased by $42 thousand to $348 thousand, fluctuates with changes in the 3-month LIBOR. Interest on other borrowings, which mostly relates to repurchase agreements, totaled $5 thousand in 2016 and $6 thousand in 2015.

As a result of the changes noted above, the net interest margin for 2016 increased to 4.21%, from 4.10% during 2015.

Provision for Loan Losses

During the year ended December 31, 2017 we recorded a provision for loan losses of $600 thousand down $200 thousand from $800 thousand during the year ended December 31, 2016. See “Analysis of Asset Quality and Allowance for Loan Losses” for further 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 inherent 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 periodically 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 potential risks in the 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.

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Non-Interest Income

The following table sets forth the components of non-interest income for the years ended December 31, 2017, 2016 and 2015.

	Years Ended December 31,			**Change during Year**	
	2017	**2016**	**2015**	**2017**	**2016**
	(dollars in thousands)				
Service charges on deposit accounts	$4,454	$4,031	$3,954	$423	$77
Gain on sale of loans, net	2,039	1,770	1,942	269	(172)
Loan servicing fees	731	642	562	89	80
Earnings on bank owned life insurance policies	338	341	342	(3)	(1)
(Loss) gain on sale of investments	(158)	(32)	21	(126)	(53)
Other income	876	900	894	(24)	6
Total non-interest income	$8,280	$7,652	$7,715	$628	$(63)

2017 compared to 2016. During the year ended December 31, 2017, non-interest income totaled $8.3 million, an increase of $628 thousand from the twelve months ended December 31, 2016. The largest components of this increase were increases of $423 thousand in service charge income, $269 thousand gain on sale of loans and $89 thousand in loan servicing income. The increase in service charge income includes significant increases in interchange income on debit card transactions, an increase in overdraft income and an increase in service charges on deposit accounts. Interchange income benefited from an increase in the size of the Bank as well as an increase in marketing efforts directed to this product, while overdraft income and service charges on deposit accounts benefited both from an increase in the size of the Bank as well as an increase in rates charged for various services beginning in October of 2016. Gains on sale of loans mostly relate to sales of SBA 7(a) loans. Gains on sale of loans increased from $1.8 million during 2016 to $2.0 million during the twelve months ended December 31, 2017. Proceeds from SBA loan sales totaled $36.6 million during 2017 and $30.7 million during the twelve months ended December 31, 2016. Loans originated for sale totaled $31.3 million during the twelve months ended December 31, 2017 and $30.4 million during 2016. Loan servicing income, which increased by $89 thousand, represents servicing income received on the guaranteed portion of SBA loans sold into the secondary market. At December 31, 2017 we were servicing $113 million in guaranteed portions of loans, an increase of $16 million from $97 million at December 31, 2016. The largest decrease in non-interest income was a $126 increase in loss on sale of investment securities from $32 thousand in 2016 to $158 thousand in 2017.

2016 compared to 2015. During the twelve months ended December 31, 2016 and 2015 non-interest income totaled $7.7 million. Increases in service charge income of $77 thousand and loan servicing fees of $80 thousand were offset by a $172 thousand decline in gain on sale of loans and an $53 thousand decline in gain on sale of investments. The increase in service charge income mostly relates to an increase in interchange fees on debit card transactions. The increase in loan servicing fees was consistent with the growth in our servicing portfolio of government guaranteed loans. At December 31, 2016 we were servicing $97 million in guaranteed portions of loans an increase of $10 million from over $86 million at December 31, 2015. During 2016, we sold $27.8 million in guaranteed portions of SBA loans, resulting in a gain on sale of $1.8 million. During 2015 we sold $26.5 million in guaranteed portions of SBA loans recording a gain of sale $1.9 million. We attribute the decline in gain on sale of SBA loans to a decline in the average of the rate paid on loans sold as well as a reduction in SBA loan sale premiums related to market conditions. During the twelve months ended December 31, 2016 we sold fourteen investment securities recording a net loss of $32 thousand. During 2015 we sold fifteen available-for-sale investment securities recording a $21,000 net gain on sale.

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Non-Interest Expense

The following table sets forth the components of other non-interest expense for the years ended December 31, 2017, 2016 and 2015.

	Years Ended December 31,			Change during Year	
	2017	**2016**	**2015**	**2017**	**2016**
	(dollars in thousands)				
Salaries and employee benefits	$11,505	$10,440	$10,277	$1,065	$163
Occupancy and equipment	2,840	2,847	2,782	(7)	65
Outside service fees	2,234	2,105	2,003	129	102
Professional fees	612	608	707	4	(99)
Telephone and data communications	561	450	376	111	74
Business development	389	344	332	45	12
Advertising and promotion	372	366	305	6	61
Director compensation education and retirement	336	348	300	(12)	48
Armored car and courier	278	248	234	30	14
Deposit insurance	248	285	362	(37)	(77)
Loan collection costs	194	166	200	28	(34)
Provision from change in OREO valuation	124	37	79	87	(42)
Stationery and supplies	118	119	105	(1)	14
Insurance	75	78	95	(3)	(17)
OREO expenses	73	(34)	182	107	(216)
Postage	49	40	41	9	(1)
Gain on sale of OREO	(130)	(60)	(198)	(70)	138
Other operating expense	233	309	309	(76)	-
Total non-interest expense	$20,111	$18,696	$18,491	$1,415	$205

2017 compared to 2016. Non-interest expense increased by $1.4 million to $20.1 million during the twelve months ended December 31, 2017, up from $18.7 million during 2016. The largest components of this increase were $1.1 million in salary and benefit expense, $129 thousand in outside service fees, $111 thousand in telephone and data communication costs and $107 thousand in OREO expenses. The largest declines in non-interest expense were $70 thousand in gain on sale of OREO and $76 thousand in other operating expense.

Salary expense increased by $481 thousand to $8.8 million related to additions to staff and merit and promotion increases. Bonus expense increased by $199 thousand related to increased profitability, commission expense, related to our SBA operations, increased by $121 thousand consistent with an increase in SBA activity, payroll tax expense increased by $81 thousand and health insurance costs increased by $67 thousand. Outside service fees increased by $129 thousand to $2.2 million during the twelve months ended December 31, 2017. This increase included an increase in expenses related to the generation of interchange income consistent with the increase in interchange income and an increase in expense related to the outsourced operations of the Company's computer network as well as an increase in costs associated with the Company's online banking offerings.

During 2017 the Company expanded its data communication network, installed a secondary fallback network at its branches and changed data communication providers. The increases in telephone and data communications was primarily related to the expanded data communication network and to a lesser extent to one-time costs related to the conversion to a new data communication provider. OREO costs in 2016 were abnormally low, benefiting from a reimbursement of previously incurred costs and $86 thousand in rental income on a new OREO property which was sold in December of 2016. During the year ended December 31, 2016 we sold 6 OREO properties for total proceeds of $2.2 million recording a net gain on sale of $60 thousand. This compares to proceeds of $0.7 million on the sale of 5 properties and a net gain on sale of $130 thousand during 2017. The $130 thousand gain is related to one property which was acquired and sold during the fourth quarter of 2017.

2016 compared to 2015. Non-interest expense increased by $205 thousand to $18.7 million during the twelve months ended December 31, 2016, up from $18.5 million during 2015. The largest components of this increase were $163 thousand in salary and benefit expense, $138 thousand related to a reduction in gain on sale of OREO properties, $102 thousand in outside service fees, $74 thousand in telephone and data communications costs, $65 thousand in occupancy and equipment expense and $61 thousand in advertising and promotion expense. The largest declines in non-interest expense were $216 thousand in OREO expenses, $99 thousand in professional fees and $77 thousand in deposit insurance expense.

The largest category of non-interest expense is salary and benefits expense. The two largest increases in this category were $247 thousand in salary expense and $225 thousand in bonus expense. Other increases in salary and benefit include $93 thousand in commissions related to SBA lending activity and $51 thousand in accrued vacation expense. Bonus expense increased from $600 thousand during the twelve months ended December 31, 2015 to $825 thousand during the current period. Offsetting the increase in salary and bonus expense was an increase of $545 thousand in the deferral of loan origination costs related to an increase in loan production. During the year ended December 31, 2015 we sold 12 OREO properties for total proceeds of $2.1 million recording a net gain on sale of $198 thousand. This compares to net proceeds of $2.2 million on the sale of 6 properties and a net gain on sale of $60 thousand during 2016. The largest component of the increase in outside service fees is $37 thousand in costs associated with the outsourcing of our email processing beginning in February, 2016. Of the $74 thousand increase in telephone and data communications $33 thousand relates to our Reno Nevada branch which opened in December, 2015 while the remainder is primarily related to an upgrade in our data communication network. The increase in occupancy and equipment costs and advertising and promotion expense also relate to the Reno branch. We have developed an aggressive marketing plan for Reno branch which includes print and radio advertising as well as various efforts to reach out to the community.

OREO costs which declined from $182 thousand during the twelve months ended December 31, 2015 to credit of $34 thousand during 2016 benefited from a reduction in OREO properties, a reimbursement of previously incurred costs and $86 thousand in rental income on a new OREO property. The OREO property that produced the rental income was sold during December, 2016. The decrease in professional fees is mostly related to a decline in legal expense related to loan collection activities as our two largest collection cases were resolved in 2016. One case resulted in a loan loss recovery of $360 thousand while the other case resulted in foreclosure on a commercial property which was sold in December, 2016.

Provision for Income Taxes. The Company recorded an income tax provision of $7.3 million, or 47.2% of pre-tax income for the year ended December 31, 2017. During 2016 the Company recorded an income tax provision of $4.8 million, or 38.9% of pre-tax income. The increase in tax provision during 2017 was related to a $1.4 million one-time revaluation of net deferred tax assets to reflect their value at the lower corporate tax rate of 21% in effect beginning January 1, 2018. In addition to the $1.4 million adjustment, the percentages for 2017 and 2016 differ from the statutory rate as tax exempt income such as earnings on Bank owned life insurance and interest on qualified municipal securities.

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 December 31, 2017 and 2016 will be fully realized and therefore no valuation allowance was recorded.

On December 22, 2017, the Tax Cuts and Jobs Act (the “TCJ Act”) was enacted into law. The TCJ Act provides for significant changes to the U.S. Internal Revenue Code of 1986, as amended. Those changes will impact corporate taxation requirements, such as the reduction of the top federal tax rate for corporations from 35% to 21%. They will also provide for changes or limitations to certain tax deductions.

The reduction in the corporate tax rate under the TCJ Act required a one-time revaluation of certain tax-related assets to reflect their value at the lower corporate tax rate of 21%. As such, the Company has recorded a reduction in the value of these assets of $1.4 million, which relates to the Company’s net deferred tax assets. Solely based on this reduction in certain tax assets, the Company recorded an additional provision for income taxes of $1.4 million, or $0.27 per diluted share, in its income statement for the fourth quarter of 2017.

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Financial Condition

Loan Portfolio. Gross loans balances increased by $25.5 million, or 5.5%, from $461 million at December 31, 2016 to $487 million at December 31, 2017. 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, equity lines of credit, agricultural loans and commercial loans.

(dollars in thousands)	Balance at End of Period 12/31/17	Percent of Loans in Each Category to Total Loans 12/31/17	Balance at End of Period 12/31/16	Percent of Loans in Each Category to Total Loans 12/31/16
Commercial	$39,620	8.1 %	$41,293	9.0 %
Agricultural	58,908	12.1 %	51,103	11.1 %
Real estate – residential	16,624	3.4 %	21,283	4.6 %
Real estate – commercial	240,257	49.4 %	226,136	49.0 %
Real estate – construction & land development	25,181	5.2 %	21,904	4.7 %
Equity Lines of Credit	41,798	8.6 %	42,338	9.2 %
Auto	60,438	12.4 %	53,553	11.6 %
Other	3,808	0.8 %	3,513	0.8 %
Total	$486,634	100 %	$461,123	100 %

Construction and land development loans represented 5.2% and 4.7% of the loan portfolio as of December 31, 2017 and December 31, 2016, respectively. The construction and land development portfolio component has been identified by Management as a higher-risk loan category. The quality of the construction and land development category is highly dependent on property values both in terms of the likelihood of repayment once the property is transacted by the current owner as well as the level of collateral the Company has securing the loan in the event of default. Loans in this category are characterized by the speculative nature of commercial and residential development properties and can include property in various stages of development from raw land to finished lots. The decline in these loans as a percentage of the Company's loan portfolio from over 21% at December 31, 2007 to less than 6% during the last two years reflects management's efforts, which began in 2009, to reduce its exposure to construction and land development loans.

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 December 31, 2017. 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 December 31, 2017 and December 31, 2016, approximately 75% and 74%, respectively of the Company's loan portfolio was comprised of variable rate loans. At December 31, 2017 and December 31, 2016, 40% and 42%, respectively 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 12.4% of gross loans at December 31, 2017. 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 Northeastern 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 $59 million at December 31, 2017 and $51 million at December 31, 2016.

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The following table sets forth the amounts of loans outstanding by category as of the dates indicated.

	At December 31,				
	2017	**2016**	**2015**	**2014**	**2013**
	(dollars in thousands)				
Real estate – mortgage	$256,881	$247,419	$217,569	$192,590	$187,264
Real estate – construction and land development	25,181	21,904	16,188	24,572	17,793
Commercial	39,620	41,293	37,084	31,465	32,612
Consumer (1)	106,044	99,404	90,274	86,408	70,235
Agriculture (2)	58,908	51,103	39,856	35,355	30,647
Total loans	486,634	461,123	400,971	370,390	338,551
Plus:					
Deferred costs	2,283	2,006	1,940	1,848	1,340
Less:					
Allowance for loan losses	6,669	6,549	6,078	5,451	5,517
Net loans	$482,248	$456,580	$396,833	$366,787	$334,374

(1) Includes equity lines of credit and auto

(2) Includes agriculture real estate

The following table sets forth the maturity of gross loan categories as of December 31, 2017. Also provided with respect to such loans are the amounts due after one year, classified according to sensitivity to changes in interest rates:

	Within One Year	**After One Through Five Years**	**After Five Years**	**Total**
	(dollars in thousands)			
Real estate – mortgage	$17,699	$56,801	$182,381	$256,881
Real estate – construction and land development	5,270	7,379	12,532	25,181
Commercial	14,339	17,355	7,926	39,620
Consumer	15,231	46,263	44,550	106,044
Agriculture	20,946	15,587	22,375	58,908
Total	$73,485	$143,385	$269,764	$486,634
Loans maturing after one year with:				
Fixed interest rates		$65,926	$28,631	$94,557
Variable interest rates		77,459	241,133	318,592
Total		$143,385	$269,764	$413,149

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.

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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 years indicated with respect to the Company's allowance for loan losses as well as charge-off and recovery activity.

	For the Year Ended December 31,				
	2017	**2016**	**2015**	**2014**	**2013**
	(dollars in thousands)				
Balance at beginning of period	$6,549	$6,078	$5,451	$5,517	$5,686