

PLUMAS BANCORP
Form 10-K
March 19, 2010

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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, 2009**

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

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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.

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

Large Accelerated Filer <input type="checkbox"/>	Accelerated Filer <input type="checkbox"/>	Non-Accelerated Filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller Reporting Company <input type="checkbox"/>
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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, 2009, the aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant was approximately \$21.7 million, based on the closing price reported to the Registrant on that date of \$4.99 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 17, 2010 was 4,776,339.

Documents Incorporated by Reference: Portions of the definitive proxy statement for the 2009 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 (the Company'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:

Competitive pressure in the banking industry, competition in the markets the Company operates in and changes in the legal, accounting and regulatory environment

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

The Company undertakes no obligation to revise or publicly release the results of any revision to these forward-looking statements. For additional information concerning risks and uncertainties related to the Company and its operations, please refer to Item 1A of this Form 10-K entitled Risk Factors and other information in this Report.

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ITEM 1. BUSINESS

General

The Company. Plumas Bancorp (the Company) 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 and acquired all of the outstanding shares of Plumas Bank (the 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, the cost of servicing debt and preferred stock dividends, will generally be paid from dividends paid to the Company by the Bank.

At December 31, 2009, the Company had consolidated assets of \$528 million, deposits of \$433 million, other liabilities of \$57 million and shareholders' equity of \$38 million. The Company's liabilities include \$10.3 million in junior subordinated deferrable interest debentures issued in conjunction with the trust preferred securities issued by Plumas Statutory Trust I (the Trust I) in September 2002 and Plumas Statutory Trust II (the Trust II) in September 2005. Both Trust I and Trust II are further discussed in the section titled *Trust Preferred Securities*. Shareholders' equity includes \$11.6 million in preferred stock issued pursuant to the U.S. government's Capital Purchase Program which is discussed in the section titled *Capital Purchase Program TARP Preferred Stock and Stock Warrant*.

References herein to the Company, we, us and our refer to Plumas Bancorp and its consolidated subsidiary, unless context indicates otherwise. 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, 2009 the Bank had approximately \$528 million in assets, \$323 million in net loans and \$437 million in deposits (including deposits of \$3.7 million from the Bancorp). 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 is participating in the Federal Deposit Insurance Corporation (FDIC) Transaction Account Guarantee Program. Under the program, through June 30, 2010, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage under the FDIC's general deposit insurance rules.

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 eleven branch network, serves the seven contiguous counties of Plumas, Nevada, Sierra, Placer, Lassen, Modoc and Shasta. The branches are located in the communities of Quincy, Portola, Greenville, Truckee, Fall River Mills, Alturas, Susanville, Chester, Tahoe City, Kings Beach and Redding. The Bank maintains fifteen automated teller machines

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(ATMs) tied in with major statewide and national networks. In addition to its branch network, the Bank operates a commercial lending office in Reno, Nevada and a lending office specializing in government-guaranteed lending in Auburn, California. 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 and home equity loans. Our principal commercial lending services include term real estate, land development and construction loans. In addition, we provide commercial and industrial term, government-guaranteed and agricultural loans as well as credit lines.

The Bank's Government-guaranteed lending center, headquartered in Auburn, California with additional personnel in Truckee, provides Small Business Administration 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 become an important part of our overall lending operation. During 2009 we sold \$10.8 million in SBA government-guaranteed loans and generated a gain on sale of \$593 thousand.

The Agricultural Credit Centers located in Susanville and Alturas 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. Agricultural 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, 2009, the principal areas to which we directed our lending activities, and the percentage of our total loan portfolio comprised by each, were as follows: (i) loans secured by real estate 60.0%; (ii) commercial and industrial loans 11.1%; (iii) consumer loans (including residential equity lines of credit) 16.4%; and (iv) agricultural loans (including agricultural real estate loans) 12.5%.

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 checking, business sweep, public funds sweep, savings, time deposit and retirement accounts, as well as remote deposit, telephone and mobile banking 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. In addition we offer a Money Fund Plus checking account for our consumer customers. These accounts pay rates comparable to those available on a money fund offered by a typical brokerage firm. As of December 31, 2009, the Bank had 31,173 deposit accounts with balances totaling approximately \$437 million, compared to 33,217 deposit accounts with balances totaling approximately \$372 million at December 31, 2008. We attract deposits through our customer-oriented product mix, competitive pricing, convenient locations, extended hours, remote deposit operations and drive-up banking, 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 \$13,900 at December 31, 2009. 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. At December 31, 2009 we had \$5 million in CDARS reciprocal time deposits which for regulatory purposes are classified as brokered deposits.

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

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In order to provide non-deposit investment options, we have developed a strategic alliance with Financial Network Investment Corporation (FNIC). Through this arrangement, certain employees of the Bank are also licensed representatives of FNIC. These employees provide our customers throughout our branch network with convenient access to annuities, insurance products, mutual funds, and a full range of investment products.

During 2007 we added Remote Deposit to our product mix. Remote Deposit allows our customers 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.

Additionally, the Bank has devoted a substantial amount of time and capital to the improvement of existing Bank services, during the last two fiscal years, including an on balance sheet business sweep product which we introduced during the first quarter of 2008. During 2009 we replaced our on-line banking service with a new state of the art product that greatly expands the features available to our customers. In addition we utilized this platform to add mobile banking services during the first quarter of 2010. 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. As our branches in less rural areas such as Truckee have expanded and with the opening our Auburn and Reno commercial lending offices, the agriculture-related base has become less significant. We are not dependent on a single customer or group of related customers for a material portion of our deposits, nor are a material portion of our loans concentrated within a single industry or group of related industries. There has been no material effect upon our capital expenditures, earnings, or competitive position as a result of federal, state, or local environmental regulation.

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 promote home ownership and affordable housing, fuel job growth and support community economic development. Types of loans offered range from personal and commercial loans to real estate, construction, agricultural, and government-guaranteed community infrastructure 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 Developments. On February 26, 2010 we closed our Loyalton and Westwood branches. Deposits and loans at these branches totaled \$18 million and \$5 million, respectively at December 31, 2009. These represent approximately 4% of total deposits and 2% of total loans at December 31, 2009. We expect most of the deposits and loans that were housed at these branches to be retained within the Bank. Westwood deposits will be transferred to our Chester branch and Loyalton deposits will be serviced from our Portola branch. Loans will continue to be serviced out of our central loan administration office located in Quincy. During the fourth quarter of 2007 the Company opened a government-guaranteed lending office in Auburn, California. During the second quarter of 2007, we opened our Redding, California branch in a temporary location and in July 2008 we relocated this branch to its permanent location.

Capital Purchase Program TARP Preferred Stock and Stock Warrant. On January 30, 2009 the Company entered into a Letter Agreement (the Purchase Agreement) with the United States Department of the Treasury (Treasury), pursuant to which the Company issued and sold (i) 11,949 shares of the Company s Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Series A Preferred Stock) and (ii) a warrant (the Warrant) to purchase 237,712 shares of the Company s common stock, no par value (the Common Stock), for an aggregate purchase price of \$11,949,000 in cash.

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The Series A Preferred Stock qualifies as Tier 1 capital and pays cumulative dividends quarterly at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The Company may redeem the Series A Preferred Stock at its liquidation preference (\$1,000 per share) plus accrued and unpaid dividends under the American Recovery and Reinvestment Act of 2009, subject to the Treasury's consultation with the Company's appropriate federal regulator.

The Warrant has a 10-year term and was immediately exercisable with an exercise price, subject to antidilution adjustments, equal to \$7.54 per share of the Common Stock. Treasury has agreed not to exercise voting power with respect to any shares of Common Stock issued upon exercise of the Warrant.

Prior to January 30, 2012, unless the Company has redeemed the Series A Preferred Stock, or the Treasury has transferred the Series A Preferred Stock to a third party, the consent of the Treasury will be required for the Company to: (1) declare or pay any dividend or make any distribution on shares of the Common Stock (other than regular quarterly cash dividends of not more than \$0.04 per share or regular semi-annual cash dividends of not more than \$0.08 per share); or (2) redeem, purchase or acquire any shares of Common Stock or other equity or capital securities, other than in connection with benefit plans consistent with past practice and certain other circumstances specified in the Purchase Agreement.

Eight million of the twelve million in proceeds from the sale of the Series A Preferred Stock was injected into Plumas Bank providing additional capital for the bank to support growth in loans and investment securities and strengthen its capital ratios. The remainder provides funds for holding company activities and general corporate purposes.

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 Connecticut 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 Debentures and trust preferred securities accrue and pay distributions quarterly based on the floating rate described above on the stated liquidation value of \$1,000 per security. The Company has entered into contractual agreements which, taken collectively, fully and unconditionally guarantee payment of: (1) accrued and unpaid distributions required to be paid on the capital securities; (2) the redemption price with respect to any capital securities called for redemption by either Trust I or Trust II, and (3) payments due upon voluntary or involuntary dissolution, winding up, or liquidation of either Trust I or Trust II.

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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.

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.

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, 2009 approximately 77% 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 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, 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 the Bank's branch service area there are 34 traditional banking branch offices of competing institutions, including 21 branches of 6 major banks. As of June 30, 2009, the Federal Deposit Insurance Corporation estimated the Bank's market share of insured deposits within the communities it serves to be as follows: Chester 67%, Quincy 59%, Portola 47%, Alturas 42%, Susanville 35%, Kings Beach 31%, Fall River Mills/Burney 19%, Truckee 16%, Tahoe City 4%, Redding less than 1% and 100% in the communities of Greenville, Westwood and Loyalton. Redding is the location of our most recently opened branch, which opened its doors in June 2007. During the first quarter of 2010 we closed our Westwood and Loyalton branches. The deposits at Westwood were transferred to our Chester office and Loyalton's deposits were transferred to our Portola branch.

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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 telephone, mail, home computer, mobile, ATMs, 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.

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, and personal computer 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, 2009, the Company and its subsidiary employed 179 persons. On a full-time equivalent basis, we employed 163 persons. We believe our employee relations are excellent.

Code of Ethics

The Board of Directors has adopted a code of business conduct and ethics for directors, officers (including Plumas Bancorp's principal executive officer and principal financial officer) and financial personnel, known as the Corporate Governance Code of Ethics. This Code of Ethics Policy is available on Plumas Bancorp'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

The Company. As a bank holding company, we are subject to regulation under the Bank Holding Company Act of 1956, as amended, (the "BHCA"), and are registered with and subject to the supervision of the Federal Reserve Bank (the "FRB"). It is the policy of the FRB, that each bank holding company serve as a source of financial and managerial strength to its subsidiary banks. We are required to file reports with the FRB and provide such additional information as the FRB may require. The FRB has the authority to examine us and our subsidiary, as well as any arrangements between us and our subsidiary, with the cost of any such examination to be borne by us.

The BHCA requires us to obtain the prior approval of the FRB before acquisition of all or substantially all of the assets of any bank or ownership or control of the voting shares of any bank if, after giving effect to the acquisition, we would own or control, directly or indirectly, more than 5% of the voting shares of that bank. Amendments to the BHCA expand the circumstances under which a bank holding company may acquire control of all or substantially all of the assets of a bank located outside the State of California.

We may not engage in any business other than managing or controlling banks or furnishing services to our subsidiary, with the exception of certain activities which, in the opinion of the FRB, are so closely related to banking or to managing or controlling banks as to be incidental to banking. In addition, we are generally prohibited from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company unless that company is engaged in such authorized activities and the Federal Reserve approves the acquisition.

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We and our subsidiary are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, sale or lease of property or provision of services. For example, with certain exceptions, the bank may not condition an extension of credit on a customer obtaining other services provided by us, the bank or any other subsidiary of ours, or on a promise by the customer not to obtain other services from a competitor. In addition, federal law imposes certain restrictions on transactions between the bank and its affiliates. As affiliates, the bank and we are subject, with certain exceptions, to the provisions of federal law imposing limitations on and requiring collateral for extensions of credit by the bank to any affiliate.

The Bank. As a California state-chartered bank that is not a member of the Federal Reserve, Plumas Bank is subject to primary supervision, examination and regulation by the FDIC, the California Department of Financial Institutions (the DFI) and is subject to applicable regulations of the FRB. The Bank's deposits are insured by the FDIC to applicable limits. As a consequence of the extensive regulation of commercial banking activities in California and the United States, banks are particularly susceptible to changes in California and federal legislation and regulations, which may have the effect of increasing the cost of doing business, limiting permissible activities or increasing competition. Various other requirements and restrictions under the laws of the United States and the State of California affect the operations of the Bank. Federal and California statutes and regulations relate to many aspects of the Bank's operations, including reserves against deposits, interest rates payable on deposits, loans, investments, mergers and acquisitions, borrowings, dividends, branching, capital requirements and disclosure obligations to depositors and borrowers. California law presently permits a bank to locate a branch office in any locality in the state. Additionally, California law exempts banks from California usury laws.

Capital Standards. The FRB and the FDIC have 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.

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. Since December 31, 1992, the FRB and the FDIC have required a minimum ratio of qualifying total capital to risk-adjusted assets and off-balance-sheet items of 8%, and a minimum ratio of Tier 1 capital to risk-adjusted assets and off-balance-sheet items of 4%.

In addition to the risk-based guidelines, the FRB and FDIC require banking organizations to maintain a minimum amount of Tier 1 capital to average total assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets is 3%. It is improbable; however, that an institution with a 3% leverage ratio would receive the highest rating by the regulators since a strong capital position is a significant part of the regulators' ratings. For all banking organizations not rated in the highest category, the minimum leverage ratio is at least 100 to 200 basis points above the 3% minimum. Thus, the effective minimum leverage ratio, for all practical purposes, is at least 4% or 5%. In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the FRB and FDIC have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios.

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A bank that does not achieve and maintain the required capital levels may be issued a capital directive by the FDIC to ensure the maintenance of required capital levels. As discussed above, we are required to maintain certain levels of capital, as is the Bank. The regulatory capital guidelines as well as the actual capitalization for the Bank and Bancorp as of December 31, 2009 follow:

	Requirement for the Bank to be:			
	Adequately Capitalized	Well Capitalized	Plumas Bank	Plumas Bancorp
Tier 1 leverage capital ratio	4.0%	5.0%	7.4%	7.9%
Tier 1 risk-based capital ratio	4.0%	6.0%	9.8%	10.4%
Total risk-based capital ratio	8.0%	10.0%	11.0%	11.6%

Prompt Corrective Action. Federal banking agencies possess broad powers to take corrective and other supervisory action to resolve the problems of insured depository institutions, including those institutions that fall below one or more prescribed minimum capital ratios described above. An institution that, based upon its capital levels, is classified as well capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions.

In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the federal regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation, or 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, the issuance of a cease-and-desist order that can be judicially enforced, the termination of insurance of deposits (in the case of a depository institution), the imposition of civil money penalties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the issuance of removal and prohibition orders against institution-affiliated parties and the enforcement of such actions through injunctions or restraining orders based upon a judicial determination that the agency would be harmed if such equitable relief was not granted. Additionally, a holding company's inability to serve as a source of strength to its subsidiary banking organizations could serve as an additional basis for a regulatory action against the holding company.

Premiums for Deposit Insurance. The deposit insurance fund of the FDIC insures our customer deposits up to prescribed limits for each depositor. The Federal Deposit Insurance Reform Act of 2005 and the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 amended the insurance of deposits by the FDIC and collection of assessments from insured depository institutions for deposit insurance. The FDIC approved a final rule in 2006 and amended the rule in February 2009 that sets an insured depository institution's assessment rate on different factors that pose a risk of loss to the Deposit Insurance Fund, including the institution's recent financial ratios and supervisory ratings, and level of reliance on a significant amount of secured liabilities or significant amount of brokered deposits (except that the factor of brokered deposits will not be considered for well capitalized institutions that are not accompanied by rapid growth). The FDIC also in February 2009 set the assessment base rates to range between \$0.12 to \$0.16 per \$100 of insured deposits on an annual basis. In May 2009, the FDIC imposed a special assessment of 5 basis points on each insured depository institution's assets less its Tier 1 capital payable on September 30, 2009 with a ceiling of 10 basis points of an institution's domestic deposits. In November 2009, the FDIC approved a final rule to require all insured depository institutions including the

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Bank to prepay three years of FDIC assessments in the fourth quarter of 2009, except in the event such prepayment is waived by the FDIC. The amount of this prepaid assessment was \$3.6 million which the Bank paid on December 30, 2009. While the prepaid assessments are not charged to income for 2009 but rather ratably over three years beginning in 2010, the quarterly amount paid reduced the cash and liquidity of the Bank at year end 2009. Due to the significant losses at failed banks and expected losses for banks that will fail, it is likely that FDIC insurance fund assessments on the Bank will continue to increase and such assessments may materially adversely affect the profitability of the Bank. Any increase in assessments or the assessment rate could have a material adverse effect on our business, financial condition, results of operations or cash flows, depending on the amount or frequency of the assessment. Furthermore, the FDIC is authorized to raise insurance premiums under certain circumstances.

The FDIC is authorized to terminate a depository institution's deposit insurance upon a finding by the FDIC that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the institution's regulatory agency. The termination of deposit insurance for the bank would have a material adverse effect on our business, financial condition, results of operations and/or cash flows.

Federal Home Loan Bank System. The Bank is a member of the Federal Home Loan Bank of San Francisco (the FHLB-SF). Among other benefits, each Federal Home Loan Bank (FHLB) serves as a reserve or central bank for its members within its assigned region. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. Each FHLB makes available loans or advances to its members in compliance with the policies and procedures established by the Board of Directors of the individual FHLB. The FHLB-SF utilizes a single class of stock with a par value of \$100 per share, which may be issued, exchanged, redeemed and repurchased only at par value. As an FHLB member, the Bank is required to own FHLB-SF capital stock in an amount equal to the greater of: a membership stock requirement with an initial cap of \$25 million (100% of membership asset value as defined), or

an activity based stock requirement (based on percentage of outstanding advances).

The FHLB-SF capital stock is redeemable on five years written notice, subject to certain conditions.

At December 31, 2009 the Bank owned 19,328 shares of the FHLB-SF capital stock.

Federal Reserve System. The FRB requires all depository institutions to maintain non-interest bearing reserves at specified levels against their transaction accounts and non-personal time deposits. At December 31, 2009, we were in compliance with these requirements.

Impact of Monetary Policies. The earnings and growth of the Company are subject to the influence of domestic and foreign economic conditions, including inflation, recession and unemployment. The earnings of the Company are affected not only by general economic conditions but also by the monetary and fiscal policies of the United States and federal agencies, particularly the FRB. The FRB can and does implement national monetary policy, such as seeking to curb inflation and combat recession, by its open market operations in United States Government securities and by its control of the discount rates applicable to borrowings by banks from the FRB. The actions of the FRB in these areas influence the growth of bank loans and leases, investments and deposits and affect the interest rates charged on loans and leases and paid on deposits. The FRB's policies have had a significant effect on the operating results of commercial banks and are expected to continue to do so in the future. The nature and timing of any future changes in monetary policies are not predictable.

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Extensions of Credit to Insiders and Transactions with Affiliates. The *Federal Reserve Act* and *FRB Regulation O* place limitations and conditions on loans or extensions of credit to:

a bank's or bank holding company's executive officers, directors and principal shareholders (*i.e.*, in most cases, those persons who own, control or have power to vote more than 10% of any class of voting securities),

any company controlled by any such executive officer, director or shareholder, or

any political or campaign committee controlled by such executive officer, director or principal shareholder.

Loans and leases extended to any of the above persons must comply with loan-to-one-borrower limits, require prior full board approval when aggregate extensions of credit to the person exceed specified amounts, 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 non-insiders, and must not involve more than the normal risk of repayment or present other unfavorable features. In addition, Regulation O provides that the aggregate limit on extensions of credit to all insiders of a bank as a group cannot exceed the bank's unimpaired capital and unimpaired surplus. Regulation O also prohibits a bank from paying an overdraft on an account of an executive officer or director, except pursuant to a written pre-authorized interest-bearing extension of credit plan that specifies a method of repayment or a written pre-authorized transfer of funds from another account of the officer or director at the bank.

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, some of which are discussed below.

The *Community Reinvestment Act* (the CRA) is intended to encourage insured depository institutions, while operating safely and soundly, to help meet the credit needs of their communities. The CRA specifically directs the federal regulatory agencies, in examining insured depository institutions, to assess a bank's record of helping meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. The CRA further requires the agencies to take a financial institution's record of meeting its community credit needs into account when evaluating applications for, among other things, domestic branches, mergers or acquisitions, or holding company formations. The agencies use the CRA assessment factors in order to provide a rating to the financial institution. The ratings range from a high of outstanding to a low of substantial noncompliance. In its last examination for CRA compliance, as of August 2005, the Bank was rated satisfactory.

The *Equal Credit Opportunity Act* (the ECOA) 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* (the 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.

The *Fair Housing Act* (the 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* (the 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* (the RFPA) 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.

Finally, the *Real Estate Settlement Procedures Act* (the 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 concern related to compliance with CRA, ECOA, TILA, FH Act, HMDA, RFPA and RESPA generally, the Company may incur additional compliance costs or be required to expend additional funds for investments in its local communities.

Recent Legislation and Other Changes. Federal and state laws affecting banking are enacted from time to time, and similarly federal and state regulations affecting banking are also adopted from time to time. The following include some of the recent laws and regulations affecting banking.

In May 2009 the Helping Families Save Their Homes Act of 2009 was enacted to help consumers avoid mortgage foreclosures on their homes through certain loss mitigation actions including special forbearance, loan modification, pre-foreclosure sale, deed in lieu of foreclosure, support for borrower housing counseling, subordinate lien resolution, and borrower relocation. The new law permits the Secretary of Housing and Urban Development (HUD), for mortgages either in default or facing imminent default, to: (1) authorize the modification of such mortgages; and (2) establish a program for payment of a partial claim to a mortgagee who agrees to apply the claim amount to payment of a mortgage on a 1- to 4-family residence. In implementing the law, the Secretary of HUD is authorized to (1) provide compensation to the mortgagee for lost income on monthly mortgage payments due to interest rate reduction; (2) reimburse the mortgagee from a guaranty fund in connection with activities that the mortgagee is required to undertake concerning repayment by the mortgagor of the amount owed to HUD; (3) make payments to the mortgagee on behalf of the borrower, under terms defined by HUD; and (4) make mortgage modification with terms extended up to 40 years from the modification date. The new law also authorizes the Secretary of HUD to: (1) reassign the mortgage to the mortgagee; (2) act as a Government National Mortgage Association (GNMA, or Ginnie Mae) issuer, or contract with an entity for such purpose, in order to pool the mortgage into a Ginnie Mae security; or (3) resell the mortgage in accordance with any program established for purchase by the federal government of insured mortgages. The new law also amends the Foreclosure Prevention Act of 2008, with respect to emergency assistance for the redevelopment of abandoned and foreclosed homes (neighborhood stabilization), to authorize each state that has received certain minimum allocations and has fulfilled certain requirements, to distribute any remaining amounts to areas with homeowners at risk of foreclosure or in foreclosure without regard to the percentage of home foreclosures in such areas.

Also in May 2009, the Credit Card Act of 2009 was enacted to help consumers and ban certain practices of credit card issuers. The new law allows interest rate hikes on existing balances only under limited conditions, such as when a promotional rate ends, there is a variable rate or if the cardholder makes a late payment. Interest rates on new transactions can increase only after the first year. Significant changes in terms on accounts cannot occur without 45 days advance notice of the change. The new law bans raising interest rates on customers based on their payment records with other unrelated credit issuers (such as utility companies and other creditors) for existing credit card balances, though card issuers would still be

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allowed to use universal default on future credit card balances if they give at least 45 days advance notice of the change. The new law allows consumers to opt out of certain significant changes in terms on their accounts. Opting out means cardholders agree to close their accounts and pay off the balance under the old terms. They have at least five years to pay the balance. Credit card issuers will be banned from issuing credit cards to anyone under 21, unless they have adult co-signers on the accounts or can show proof they have enough income to repay the card debt. Credit card companies must stay at least 1,000 feet from college campuses if they are offering free pizza or other gifts to entice students to apply for credit cards.

The new requires card issuers to give card account holders a reasonable amount of time to make payments on monthly bills. That means payments would be due at least 21 days after they are mailed or delivered. Credit card issuers would no longer be able to set early morning or other arbitrary deadlines for payments. When consumers have accounts that carry different interest rates for different types of purchases payments in excess of the minimum amount due must go to balances with higher interest rates first. Consumers must opt in to over-limit fees. Those who opt out would have their transactions rejected if they exceed their credit limits, thus avoiding over-limit fees. Fees charged for going over the limit must be reasonable. Finance charges on outstanding credit card balances would be computed based on purchases made in the current cycle rather than going back to the previous billing cycle to calculate interest charges. Fees on credit cards cannot exceed 25 percent of the available credit limit in the first year of the card. Credit card issuers must disclose to cardholders the consequences of making only minimum payments each month, namely how long it would take to pay off the entire balance if users only made the minimum monthly payment. Issuers must also provide information on how much users must pay each month if they want to pay off their balances in 36 months, including the amount of interest.

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (ARRA) was enacted to provide stimulus to the struggling US economy. ARRA authorizes spending of \$787 billion, including about \$288 billion for tax relief, \$144 billion for state and local relief aid, and \$111 billion for infrastructure and science. In addition, ARRA includes additional executive compensation restrictions for recipients of funds from the US Treasury under the Troubled Assets Relief Program of the Emergency Economic Stimulus Act of 2008 (EESA). The provisions of EESA amended by the ARRA include (i) expanding the coverage of the executive compensation limits to as many as the 25 most highly compensated employees of a TARP funds recipient and its affiliates for certain aspects of executive compensation limits and (ii) specifically limiting incentive compensation of covered executives to one-third of their annual compensation which is required to be paid in restricted stock that does not vest until all of the TARP funds are no longer outstanding (note that if TARP warrants remain outstanding and no other TARP instruments are outstanding, then such warrants would not be considered outstanding for purposes of this incentive compensation restriction. In addition, the board of directors of any TARP recipient is required under EESA, as amended to have a company-wide policy regarding excessive or luxury expenditures, as identified by the Treasury, which may include excessive expenditures on entertainment or events; office and facility renovations; aviation or other transportation services; or other activities or events that are not reasonable expenditures for staff development, reasonable performance incentives, or other similar measures conducted in the normal course of the business operations of the TARP recipient.

EESA, as amended by ARRA, provides for a new incentive compensation restriction for financial institutions receiving TARP funds. The number of executives and employees covered by this new incentive compensation restriction depends on the amount of TARP funds received by such entity. For community banks that have or will receive less than \$25 million, the new incentive compensation restriction applies only to the highest paid employee. This new incentive compensation restriction prohibits a TARP recipient from paying or accruing any bonus, retention award, or incentive compensation during the period in which any TARP obligation remains outstanding, except that such prohibition shall not apply to the payment of long-term restricted stock by such TARP recipient, provided that such long-term restricted stock (i) does not fully vest during the period in which any TARP obligation remains outstanding, (ii) has a value in an amount that is not greater than 1/3 of the total amount of annual compensation of the employee receiving the stock; and (iii) is subject to such other terms and conditions as the Secretary of the Treasury may determine is in the public interest. In addition, this prohibition does not prohibit any bonus payment required to be paid pursuant to a written employment contract executed on or before February 11, 2009, as such valid

employment contracts are determined by the Treasury.

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EESA was amended by ARRA to also provide additional corporate governance provisions with respect to executive compensation including the following:

ESTABLISHMENT OF STANDARDS During the period in which any TARP obligation remains outstanding, each TARP recipient shall be subject to the standards in the regulations issued by the Treasury with respect to executive compensation limitations for TARP recipients, and the provisions of section 162(m)(5) of the Internal Revenue Code of 1986, as applicable (nondeductibility of executive compensation in excess of \$500,000).

COMPLIANCE WITH STANDARDS The Treasury is required to see that each TARP recipient meet the required standards for executive compensation and corporate governance.

SPECIFIC REQUIREMENTS FOR THE REQUIRED STANDARDS

Limits on compensation that exclude incentives for senior executive officers of the TARP recipient to take unnecessary and excessive risks that threaten the value of the financial institution during the period in which any TARP obligation remains outstanding.

A clawback requirement by such TARP recipient of any bonus, retention award, or incentive compensation paid to a senior executive officer and any of the next 20 most highly-compensated employees of the TARP recipient based on statements of earnings, revenues, gains, or other criteria that are later found to be materially inaccurate.

A prohibition on such TARP recipient making any golden parachute payment to a senior executive officer or any of the next 5 most highly-compensated employees of the TARP recipient during the period in which any TARP obligation remains outstanding.

A prohibition on any compensation plan that would encourage manipulation of the reported earnings of such TARP recipient to enhance the compensation of any of its employees.

A requirement for the establishment of an independent Compensation Committee that meets at least twice a year to discuss and evaluate employee compensation plans in light of an assessment of any risk posed to the TARP recipient from such plans. For a non SEC company that is a TARP recipient that has received \$25,000,000 or less of TARP assistance, the duties of the compensation committee may be carried out by the board of directors of such TARP recipient.

In addition, EESA as amended by ARRA provides that for any TARP recipient, its annual meeting materials shall include a nonbinding shareholder approval proposal of executive compensation for shareholders to vote. The SEC is to establish regulations to implement this provision. While nonpublic companies are required to include this proposal, it is not known what the regulations will provide as to executive compensation disclosure requirements of such TARP recipients, and whether they will be as extensive as the existing SEC executive compensation requirements. In addition, shareholders are allowed to present other nonbinding proposals with respect to executive compensation. ARRA also provides \$730 million to the SBA and makes changes to the agency's lending and investment programs so that they can reach more small businesses that need help. The funding includes:

\$375 million for temporarily eliminating fees on SBA-backed loans and raising SBA's guarantee percentage on some loans to 90 percent.

\$255 million for a new loan program to help small businesses meet existing debt payments

\$30 million for expanding SBA's Microloan program, enough to finance up to \$50 million in new lending and \$24 million in technical assistance grants to microlenders.

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On February 10, 2009, the U. S. Treasury, the Federal Reserve Board, the FDIC, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision all announced a comprehensive set of measures to restore confidence in the strength of U.S. financial institutions and restart the critical flow of credit to households and businesses. This program is intended to restore the flows of credit necessary to support recovery.

The core program elements include:

A new Capital Assistance Program to help ensure that our banking institutions have sufficient capital to withstand the challenges ahead, paired with a supervisory process to produce a more consistent and forward-looking assessment of the risks on banks' balance sheets and their potential capital needs.

A new Public-Private Investment Fund on an initial scale of up to \$500 billion, with the potential to expand up to \$1 trillion, to catalyze the removal of legacy assets from the balance sheets of financial institutions. This fund will combine public and private capital with government financing to help free up capital to support new lending.

A new Treasury and Federal Reserve initiative to dramatically expand up to \$1 trillion the existing Term Asset-Backed Securities Lending Facility (TALF) in order to reduce credit spreads and restart the securitized credit markets that in recent years supported a substantial portion of lending to households, students, small businesses, and others.

An extension of the FDIC's Temporary Liquidity Guarantee Program to October 31, 2009. A new framework of governance and oversight to help ensure that banks receiving funds are held responsible for appropriate use of those funds through stronger conditions on lending, dividends and executive compensation along with enhanced reporting to the public.

In October 2008, the President signed the Emergency Economic Stabilization Act of 2008 (EESA), in response to the global financial crisis of 2008 authorizing the United States Secretary of the Treasury with authority to spend up to \$700 billion to purchase distressed assets, especially mortgage-backed securities, under the Troubled Assets Relief Program (TARP) and make capital injections into banks under the Capital Purchase Program. EESA gives the government the unprecedented authority to buy troubled assets on balance sheets of financial institutions under the Troubled Assets Relief Program and increases the limit on insured deposits from \$100,000 to \$250,000 through December 31, 2009. Some of the other provisions of EESA are as follows:

accelerated from 2011 to 2008 the date that the Federal Reserve Bank could pay interest on deposits of banks held with the Federal Reserve to meet reserve requirements;

to the extent that the U. S. Treasury purchases mortgage securities as part of TARP, the Treasury shall implement a plan to minimize foreclosures including using guarantees and credit enhancements to support reasonable loan modifications, and to the extent loans are owned by the government to consent to the reasonable modification of such loans;

limits executive compensation for executives for TARP participating financial institutions including a maximum corporate tax deduction limit of \$500,000 for each of the top five highest paid executives of such institution, requiring clawbacks of incentive compensation that were paid based on inaccurate or false information, limiting golden parachutes for involuntary and certain voluntary terminations to 2.99x their average annual salary and bonus for the last five years, and prohibiting the payment of incentive compensation that encourages management to take unnecessary and excessive risks with respect to the institution;

extends the mortgage debt forgiveness provision of the Mortgage Forgiveness Debt Relief Act of 2007 by three years (2012) to ease the income tax burden on those involved with certain foreclosures; and

qualified financial institutions may count losses on FNMA and FHLMC preferred stock against ordinary income, rather than capital gain income.

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On February 10, 2009, the Treasury Secretary announced a new comprehensive financial stability legislation (the Financial Stability Plan), which earmarked the second \$350 billion of unused funds originally authorized under the EESA. The major elements of the Financial Stability Plan included: (i) a capital assistance program that has invested in convertible preferred stock of certain qualifying institutions, (ii) a consumer and business lending initiative to fund new consumer loans, small business loans and commercial mortgage asset-backed securities issuances, (iii) a public/private investment fund intended to leverage public and private capital with public financing to purchase up to \$500 billion to \$1 trillion of legacy toxic assets from financial institutions, and (iv) assistance for homeowners by providing up to \$75 billion to reduce mortgage payments and interest rates and establishing loan modification guidelines for government and private programs.

On October 22, 2009, the Federal Reserve Board issued a comprehensive proposal on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The proposal, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. The proposal also contemplates a detailed review by the Federal Reserve Board of the incentive compensation policies and practices of a number of large, complex banking organizations. Any deficiencies in compensation practices that are identified may be incorporated into the organization's supervisory ratings, which can affect its ability to make acquisitions or perform other actions. In addition, the proposal provides that enforcement actions may be taken against a banking organization if its incentive compensation arrangements or related risk-management control or governance processes pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies. Similarly, on January 12, 2010, the FDIC announced that it would seek public comment through advance notice of rule making on whether banks with compensation plans that encourage risky behavior should be charged at higher deposit assessment rates than such banks would otherwise be charged.

On September 3, 2009, the U.S. Treasury issued a policy statement entitled Principles for Reforming the U.S. and International Regulatory Capital Framework for Banking Firms. The statement was developed in consultation with the U.S. bank regulatory agencies and sets forth eight core principles intended to shape a new international capital accord. Six of the core principles relate directly to bank capital requirements. The statement contemplates changes to the existing regulatory capital regime that would involve substantial revisions to, if not replacement of, major parts of the Basel I and Basel II and affect all regulated banking organizations and other systemically important institutions. The statement calls for higher and stronger capital requirements for bank and non-bank financial firms that are deemed to pose a risk to financial stability due to their combination of size, leverage, interconnectedness and liquidity risk. The statement suggested that changes to the regulatory capital framework be phased in over a period of several years with a recommended schedule providing for a comprehensive international agreement by December 31, 2010, with the implementation of reforms by December 31, 2012, although it does remain possible that U.S. bank regulatory agencies could officially adopt, or informally implement, new capital standards at an earlier date. Following the issuance of the statement, on December 17, 2009, the Basel committee issued a set of proposals (the Capital Proposals) that would significantly revise the definitions of Tier 1 capital and Tier 2 capital, with the most significant changes being to Tier 1 capital. Most notably, the Capital Proposals would disqualify certain structured capital instruments, such as trust preferred securities, from Tier 1 capital status. The Capital Proposals would also re-emphasize that common equity is the predominant component of Tier 1 capital by adding a minimum common equity to risk-weighted assets ratio and requiring that goodwill, general intangibles and certain other items that currently must be deducted from Tier 1 capital instead be deducted from common equity as a component of Tier 1 capital. The Capital Proposals also leave open the possibility that the Basel committee will recommend changes to the minimum Tier 1 capital and total capital ratios of 4.0% and 8.0%, respectively. Concurrently with the release of the Capital Proposals, the Basel committee also released a set of proposals related to liquidity risk exposure (the Liquidity Proposals). The Liquidity Proposals have three key elements, including the implementation of (i) a liquidity coverage ratio designed to ensure that a bank maintains an adequate

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level of unencumbered, high-quality assets sufficient to meet the bank's liquidity needs over a 30-day time horizon under an acute liquidity stress scenario, (ii) a net stable funding ratio designed to promote more medium and long-term funding of the assets and activities of banks over a one-year time horizon, and (iii) a set of monitoring tools that the Basel committee indicates should be considered as the minimum types of information that banks should report to supervisors and that supervisors should use in monitoring the liquidity risk profiles of supervised entities.

In June 2009, the Administration proposed a wide range of regulatory reforms that, if enacted, may have significant effects on the financial services industry in the United States. Significant aspects of the Administration's proposals included, among other things, proposals (i) that any financial firm whose combination of size, leverage and interconnectedness could pose a threat to financial stability be subject to certain enhanced regulatory requirements, (ii) that federal bank regulators require loan originators or sponsors to retain part of the credit risk of securitized exposures, (iii) that there be increased regulation of broker-dealers and investment advisers, (iv) for the creation of a federal consumer financial protection agency that would, among other things, be charged with applying consistent regulations to similar products (such as imposing certain notice and consent requirements on consumer overdraft lines of credit), (v) that there be comprehensive regulation of OTC derivatives, (vi) that the controls on the ability of banking institutions to engage in transactions with affiliates be tightened, and (vii) that financial holding companies be required to be well-capitalized and well-managed on a consolidated basis. The Congress, state lawmaking bodies and federal and state regulatory agencies continue to consider a number of wide-ranging and comprehensive proposals for altering the structure, regulation and competitive relationships of the nation's financial institutions, including rules and regulations related to the broad range of reform proposals set forth by the Obama administration described above. Along with amendments to the Administration's proposal there are separate comprehensive financial reform bills intended to address in part or whole or vary in part or in whole from the proposals set forth by the Administration were introduced in both houses of Congress in the second half of 2009 and in 2010 and remain under review by both the U.S. House of Representatives and the U.S. Senate.

The Temporary Liquidity Guarantee Program was implemented by the FDIC on October 14, 2008 to mitigate the lack of liquidity in the financial markets. The Temporary Liquidity Guarantee Program has two primary components: the Debt Guarantee Program, by which the FDIC will guarantee the payment of certain newly-issued senior unsecured debt, and the Transaction Account Guarantee Program, by which the FDIC will guarantee certain noninterest-bearing and low interest-bearing transaction accounts. The Debt Guarantee Program provides for an FDIC guarantee as to the payment of all senior unsecured debt (with a term of more than 30 days) issued by a qualified participating entity (insured depository institutions, bank and financial holding companies, and certain savings and loan holding companies) up to a limit of 125 percent of all senior unsecured debt outstanding on September 30, 2008, and maturing by June 30, 2009. The FDIC guarantee is until June 30, 2012, and the fee for such guarantee depends on the term with a maximum of 100 basis points for terms in excess of 365 days. The Transaction Account Guarantee Program is the second part of the FDIC's Temporary Liquidity Guarantee Program. The FDIC provides for a temporary full guarantee held at a participating FDIC-insured depository institution of noninterest-bearing and low interest-bearing transaction accounts above the existing deposit insurance limit at the additional cost of 10 basis points per annum. This coverage became effective on October 14, 2008, and will continue through June 30, 2010.

On July 30, 2008, the Housing and Economic Recovery Act was signed by the President. It authorizes the Federal Housing Administration to guarantee up to \$300 billion in new 30-year fixed rate mortgages for subprime borrowers if lenders write-down principal loan balances to 90 percent of current appraisal value. It is also intended to restore confidence in Fannie Mae and Freddie Mac by strengthening regulations and injecting capital into them. States will be authorized to refinance subprime loans using mortgage revenue bonds. It also establishes the Federal Housing Finance Agency out of the Federal Housing Finance Board and Office of Federal Housing Enterprise Oversight.

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In 2008, the Federal Reserve Board, the FDIC, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision amended their regulatory capital rules to permit banks, bank holding companies, and savings associations (as to any of these a financial institution) to reduce the amount of goodwill that a banking organization must deduct from tier 1 capital by the amount of any deferred tax liability associated with that goodwill. However, a financial institution that reduces the amount of goodwill deducted from tier 1 capital by the amount of the deferred tax liability is not permitted to net this deferred tax liability against deferred tax assets when determining regulatory capital limitations on deferred tax assets. For these financial institutions, the amount of goodwill deducted from tier 1 capital will reflect each institution's maximum exposure to loss in the event that the entire amount of goodwill is impaired or derecognized, an event which triggers the concurrent derecognition of the related deferred tax liability for financial reporting purposes.

On October 7, 2008 the FDIC adopted a restoration plan that would increase the rates banks pay for deposit insurance, and proposed rules for adjusting the system that determines what deposit insurance premium rate a bank pays the FDIC. Currently, banks pay anywhere from five basis points to 43 basis points for deposit insurance. Under the proposal rule, the assessment rate schedule would be raised uniformly by 7 basis points (annualized) beginning on January 1, 2009. Beginning with the second quarter of 2009, changes would be made to the deposit insurance assessment system to make the increase in assessments fairer by requiring riskier institutions to pay a larger share. Together, the proposed changes would improve the way the system differentiates risk among insured institutions and help ensure that the reserve ratio returns to at least 1.15 percent by the end of 2013. The proposed changes to the assessment system include assessing higher rates to institutions with a significant reliance on secured liabilities, which generally raises the FDIC's loss in the event of failure without providing additional assessment revenue. The proposal also would assess higher rates for institutions with a significant reliance on brokered deposits but, for well-managed and well-capitalized institutions, only when accompanied by rapid asset growth. Brokered deposits combined with rapid asset growth have played a role in a number of costly failures, including some recent ones. The proposal also would provide incentives in the form of a reduction in assessment rates for institutions to hold long-term unsecured debt and, for smaller institutions, high levels of Tier 1 capital. The FDIC also voted to maintain the Designated Reserve Ratio at 1.25 percent as a signal of its long term target for the fund.

The Federal Reserve Board in October 2008 approved final amendments to Regulation C that revise the rules for reporting price information on higher-priced mortgage loans. The changes are intended to improve the accuracy and usefulness of data reported under the Home Mortgage Disclosure Act. Regulation C currently requires lenders to collect and report the spread between the annual percentage rate (APR) on a mortgage loan and the yield on a Treasury security of comparable maturity if the spread is greater than 3.0 percentage points for a first lien loan or greater than 5.0 percentage points for a subordinate lien loan. This difference is known as a rate spread. Under the final rule, a lender will report the spread between the loan's APR and a survey-based estimate of APRs currently offered on prime mortgages of a comparable type (average prime offer rate) if the spread is equal to or greater than 1.5 percentage points for a first lien loan or equal to or greater than 3.5 percentage points for a subordinate-lien loan. The Board will publish average prime offer rates based on the Primary Mortgage Market Survey® currently published by Freddie Mac. In setting the rate spread reporting threshold, the Board sought to cover subprime mortgages and generally avoid covering prime mortgages. The changes to Regulation C conform the threshold for rate spread reporting to the definition of higher-priced mortgage loans adopted by the Board under Regulation Z (Truth in Lending) in July of 2008.

The Federal Reserve Board in July 2008 approved a final rule for home mortgage loans to better protect consumers and facilitate responsible lending. The rule prohibits unfair, abusive or deceptive home mortgage lending practices and restricts certain other mortgage practices. The final rule also establishes advertising standards and requires certain mortgage disclosures to be given to consumers earlier in the transaction. The final rule, which amends Regulation Z (Truth in Lending) and was adopted under the Home Ownership and Equity Protection Act (HOEPA), largely follows a proposal released by the Board in December 2007, with enhancements that address ensuing public comments, consumer testing, and further analysis.

The final rule adds four key protections for a newly defined category of higher-priced mortgage loans secured by a consumer's principal dwelling. For loans in this category, these protections will:

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Prohibit a lender from making a loan without regard to borrowers' ability to repay the loan from income and assets other than the home's value. A lender complies, in part, by assessing repayment ability based on the highest scheduled payment in the first seven years of the loan. To show that a lender violated this prohibition, a borrower does not need to demonstrate that it is part of a pattern or practice.

Require creditors to verify the income and assets they rely upon to determine repayment ability.

Ban any prepayment penalty if the payment can change in the initial four years. For other higher-priced loans, a prepayment penalty period cannot last for more than two years.

Require creditors to establish escrow accounts for property taxes and homeowner's insurance for all first-lien mortgage loans.

In addition to the rules governing higher-priced loans, the rules adopt the following protections for loans secured by a consumer's principal dwelling, regardless of whether the loan is higher-priced:

Creditors and mortgage brokers are prohibited from coercing a real estate appraiser to misstate a home's value.

Companies that service mortgage loans are prohibited from engaging in certain practices, such as pyramiding late fees. In addition, servicers are required to credit consumers' loan payments as of the date of receipt and provide a payoff statement within a reasonable time of request.

Creditors must provide a good faith estimate of the loan costs, including a schedule of payments, within three days after a consumer applies for any mortgage loan secured by a consumer's principal dwelling, such as a home improvement loan or a loan to refinance an existing loan. Currently, early cost estimates are only required for home-purchase loans. Consumers cannot be charged any fee until after they receive the early disclosures, except a reasonable fee for obtaining the consumer's credit history.

For all mortgages, the rule also sets additional advertising standards. Advertising rules now require additional information about rates, monthly payments, and other loan features. The final rule bans seven deceptive or misleading advertising practices, including representing that a rate or payment is fixed when it can change. The rule's definition of higher-priced mortgage loans will capture virtually all loans in the subprime market, but generally exclude loans in the prime market. To provide an index, the Federal Reserve Board will publish the average prime offer rate, based on a survey currently published by Freddie Mac. A loan is higher-priced if it is a first-lien mortgage and has an annual percentage rate that is 1.5 percentage points or more above this index, or 3.5 percentage points if it is a subordinate-lien mortgage. The new rules take effect on October 1, 2009. The single exception is the escrow requirement, which will be phased in during 2010 to allow lenders to establish new systems as needed.

In California, the enactment of AB329 in 2009, the Reverse Mortgage Elder Protection Act of 2009 prohibits a lender or any other person who participates in the origination of the mortgage from participation in, being associated with, or employing any party that participates in or is associated with any other financial or insurance activity or referring a prospective borrower to anyone for the purchase of other financial or insurance products; and imposes certain disclosure requirements on the lender.

The enactment of AB1160 in 2009, requires a supervised financial institution in California that negotiates primarily in any of a number of specified languages in the course of entering into a contract or agreement for a loan or extension of credit secured by residential real property, to deliver, prior to the execution of the contract or agreement, and no later than 3 business days after receiving the written application, a specified form in that language summarizing the terms of the contract or agreement; provides for administrative penalties for violations; and requires the California Department of Corporations and the Department of Financial Institutions to create a form for providing translations and make it available in Spanish, Chinese, Tagalog, Vietnamese and Korean. The statute becomes operative on July 1, 2010, or 90 days after issuance of the form, whichever occurs later.

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The enactment of AB 1291 in 2009 makes changes to the California Unclaimed Property Law including (among other things): allowing electronic notification to customers who have consented to electronic notice; requiring that notices contain certain information and allow the holder to provide electronic means to enable the owner to contact the holder in lieu of returning the prescribed form to declare the owner's intent; authorizing the holder to give additional notices; and requiring, beginning January 1, 2011, a banking or financial organization to provide a written notice regarding escheat at the time a new account or safe deposit box is opened.

The enactment of SB306 makes specified changes to clarify existing law related to filing a notice of default on residential real property in California, including (among other things): clarifying that the provisions apply to mortgages and deeds of trust recorded from January 1, 2003 through December 31, 2007, secured by owner-occupied 3-4 residential real property containing no more than 4 dwelling units; revising the declaration to be filed with the notice of default; specifying how the loan servicers have to maximize net present value under their pooling and servicing agreements applies to certain investors; specifying how and when the notice to residents of property subject to foreclosure is to be mailed; and extending the time during which the notice of sale must be recorded from 14 to 20 days. The bill also makes certain changes related to short-pay agreements and short-pay demand statements.

On February 20, 2009, Governor Schwarzenegger signed ABX2-7 and SBX2-7, which established the California Foreclosure Prevention Act. The California Foreclosure Prevention Act modifies the foreclosure process to provide additional time for borrowers to work out loan modifications while providing an exemption for mortgage loan servicers that have implemented a comprehensive loan modification program. Civil Code Section 2923.52 requires an additional 90-day period beyond the period already provided before a Notice of Sale can be given in order to allow all parties to pursue a loan modification to prevent foreclosure of loans meeting certain criteria identified in that section.

A mortgage loan servicer who has implemented a comprehensive loan modification program may file an application for exemption from the provisions of Civil Code Section 2923.52. Approval of this application provides the mortgage loan servicer an exemption from the additional 90-day period before filing the Notice of Sale when foreclosing on real property covered by the new law.

California Assembly Bill 1301 was signed by the Governor on July 16, 2008 and became law on January 1, 2009. Among other things, the bill eliminated unnecessary applications that consume time and resources of bank licensees and which in many cases are now perfunctory. All of current Article 5 - Locations of Head Office of Chapter 3, and all of Chapter 4 - Branch Offices, Other Places of Business and Automated Teller Machines were repealed. A new Chapter 4 - Bank Offices was added. The new Chapter 4 requires notice to the California Department of Financial Institutions (DFI) the establishment of offices, rather than the current application process. Many of the current branch applications are perfunctory in nature and/or provide for a waiver of application. Banks, on an exception basis, may be subject to more stringent requirements as deemed necessary. As an example, new banks, banks undergoing a change in ownership and banks in less than satisfactory condition may be required to obtain prior approval from the DFI before establishing offices if such activity is deemed to create an issue of safety and soundness. The bill eliminated unnecessary provisions in the Banking Law that are either outdated or have become undue restrictions to bank licensees. Chapter 6 - Powers and Miscellaneous Provisions was repealed. A new Chapter 6 - Restrictions and Prohibited Practices was added. This chapter brings together restrictions in bank activities as formerly found in Chapter 18 - Prohibited Practices and Penalties. However, in bringing the restrictions into the new chapter, various provisions were updated to remove the need for prior approval by the DFI Commissioner. The bill renumbered current Banking Law sections to align like sections. Chapter 4.5 - Authorizations for Banks was added. The purpose of the chapter is to provide exceptions to certain activities that would otherwise be prohibited by other laws outside of the Financial Code. The bill added Article 1.5 - Loan and Investment Limitations to Chapter 10 - Commercial Banks. This article is new in concept and acknowledges that investment decisions are business decisions so long as there is a diversification of the investments to spread any risk. The risk is diversified in this article by placing a limitation on the loans and investments that can be made to any one entity. This section is a trade-off for elimination of applications to the DFI for approval of investments in securities, which were repealed.

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Other changes AB 1301 made to the Banking Law:

Authorized a bank or trust acting in any capacity under a court or private trust to arrange for the deposit of securities in a securities depository or federal reserve bank, and provided how they may be held by the securities depository;

Reduced from 5% to 1% the amount of eligible assets to be maintained at an approved depository by an office of a foreign (other nation) bank for the protection of the interests of creditors of the bank's business in this state or for the protection of the public interest;

Enabled the DFI to issue an order against a bank licensee parent or subsidiary;

Provided that the examinations may be conducted in alternate examination periods if the DFI concludes that an examination of the state bank by the appropriate federal regulator carries out the purpose of this section, but the DFI may not accept two consecutive examination reports made by federal regulators;

Provided that the DFI may examine subsidiaries of every California state bank, state trust company, and foreign (other nation) bank to the extent and whenever and as often as the DFI shall deem advisable;

Enabled the DFI issue an order or a final order to now include any bank holding company or subsidiary of the bank, trust company, or foreign banking corporation that is violating or failing to comply with any applicable law, or is conducting activities in an unsafe or injurious manner;

Enabled the DFI to take action against a person who has engaged in or participated in any unsafe or unsound act with regard to a bank, including a former employee who has left the bank.

Recent Accounting Pronouncements

See Note 2 Summary of Significant Accounting Policies Adoption of New Financial 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

As a smaller reporting company we are not required to provide the information required by this item.

ITEM 1B. UNRESOLVED STAFF COMMENTS

No comments have been submitted to the registrant by the staff of the Securities Exchange Commission.

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ITEM 2. PROPERTIES

Of the Company's thirteen depository branches, ten are owned and three are leased. The Company also leases two 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	315 Birch Street Westwood, California (2)
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	

Leased Properties

243 North Lake Boulevard Tahoe City, California	604 Main Street Loyalton, California (2)	2175 Civic Center Drive Redding, California
1005 Terminal Way, Ste. 246 Reno, Nevada (3)	470 Nevada St., Suite 108 Auburn, California (3)	

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

(2) Traditional banking services were discounted at these branches on February 26, 2010. ATMs remain to service our customers.

(3) Commercial lending offices.

Total rental expenses under all leases, including premises, totaled \$317,000, \$347,000 and \$209,000, in 2009, 2008 and 2007 respectively. The expiration dates of the leases vary, with the first such lease expiring during 2010 and the last such lease expiring during 2018. Future minimum lease payments in thousands of dollars are as follows:

Year Ending December 31,	
2010	\$ 265,000
2011	234,000
2012	234,000
2013	258,000
2014	143,000
Thereafter	465,000
	\$ 1,499,000

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. (REMOVED AND RESERVED)

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER 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, 2009, there were 4,776,339 shares of the Company's stock outstanding held by approximately 1,850 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	High	Low
4 th Quarter 2009		\$ 4.80	\$ 2.88
3 rd Quarter 2009		\$ 4.99	\$ 3.80
2 nd Quarter 2009		\$ 5.96	\$ 3.80
1 st Quarter 2009		\$ 7.81	\$ 3.80
4 th Quarter 2008	\$ 0.08	\$ 11.00	\$ 3.80
3 rd Quarter 2008		\$ 11.97	\$ 8.97
2 nd Quarter 2008	\$ 0.16	\$ 14.93	\$ 10.34
1 st Quarter 2008		\$ 14.41	\$ 9.75

Dividends paid to shareholders by the Company are subject to restrictions set forth in California General Corporation Law, which provides that a corporation may make a distribution to its shareholders if retained earnings immediately prior to the dividend payout are at least equal to the amount of the proposed distribution. As a bank holding company without significant assets other than its equity position in the Bank, the Company's ability to pay dividends to its shareholders depends primarily upon dividends it receives from the Bank. Such dividends paid by the Bank to the Company are subject to certain limitations. See Note 11 "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.

On January 30, 2009, under the Capital Purchase Program, the Company entered into a Letter Agreement (the "Purchase Agreement") with the United States Department of the Treasury ("Treasury"), pursuant to which the Company issued and sold (i) 11,949 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Preferred Shares") and (ii) a ten-year warrant to purchase up to 237,712 shares of the Company's common stock, no par value at an exercise price, subject to anti-dilution adjustments, of \$7.54 per share, for an aggregate purchase price of \$11,949,000 in cash. The Series A Preferred Stock and the Warrant were issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. As described in the following paragraph the Purchase Agreement contains provisions that restrict the payment of dividends on Plumas Bancorp common stock and restrict the Company's ability to repurchase Plumas Bancorp common stock.

Under the Purchase Agreement, prior to January 30, 2012, unless the Company has redeemed the Preferred Shares, or the Treasury has transferred the Preferred Shares to a third party, the consent of the Treasury will be required for the Company to: (1) declare or pay any dividend or make any distribution on shares of the Common Stock (other than regular quarterly cash dividends of not more than \$0.04 per share or regular semi-annual cash dividends of not more than \$0.08 per share); or (2) redeem, purchase or acquire any shares of Common Stock or other equity or capital securities, other than in connection with benefit plans consistent with past practice and certain other circumstances specified in the Purchase Agreement.

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"). The Board will periodically, but on no regular schedule, review the appropriateness of a cash dividend

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payment. The Board by resolution shall set the amount, the record date and the payment date of any dividend after considering numerous factors, including the Company's regulatory capital requirements, earnings, financial condition and the need for capital for expanded growth and general economic conditions. No common dividends were paid in 2009 and none are anticipated to be paid in 2010. Additionally, no assurance can be given that cash or stock dividends will be paid in the future.

On January 22, 2007 the Company announced that the Board authorized a common stock repurchase plan for the year ending December 31, 2007. The plan authorized the repurchase of up to 250,000 shares, or approximately 5%, of the Company's shares outstanding as of January 22, 2007. A total of 168,737 common shares, at an average cost, including commission, of \$14.22 per share, were repurchased under this plan during 2007.

On December 20, 2007 the Company announced that for 2008 the Board authorized a common stock repurchase plan for up to 244,000 shares, or 5% of the Company's shares outstanding on December 20, 2007. During the year ended December 31, 2008 the Company repurchased 106,267 shares at an average cost, including commission, of \$11.45 per share. This plan terminated on December 31, 2008 and, related to its Purchase Agreement with the Treasury described above, the Company is temporarily restricted from making additional share repurchases without approval from the Treasury.

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, 2009.

Plan Category	Number of securities to be issued upon exercise of outstanding options (a)	Weighted-average exercise price of outstanding options (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	403,966	\$ 13.56	469,219
Equity compensation plans not approved by security holders	None	Not Applicable	None
Total	403,966	\$ 13.56	469,219

For additional information related to the above plans see Note 11 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 2009.

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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,				
	2009	2008	2007	2006	2005
	<i>(dollars in thousands except per share information)</i>				
Statement of Income					
Interest income	\$ 22,836	\$ 25,440	\$ 30,284	\$ 29,483	\$ 25,497
Interest expense	3,655	5,364	8,536	6,954	4,793
Net interest income	19,181	20,076	21,748	22,529	20,704
Provision for loan losses	14,500	4,600	800	1,000	1,100
Noninterest income	5,752	5,091	5,448	5,159	5,073
Noninterest expense	26,354	20,475	19,671	18,290	17,549
(Benefit from) provision for income taxes	(6,775)	(212)	2,502	3,196	2,600
Net (loss) income	\$ (9,146)	\$ 304	\$ 4,223	\$ 5,202	\$ 4,528
Balance sheet (end of period)					
Total assets	\$ 528,117	\$ 457,175	\$ 453,115	\$ 473,239	\$ 472,803
Total loans	\$ 332,678	\$ 366,017	\$ 352,949	\$ 354,712	\$ 321,646
Allowance for loan losses	\$ 9,568	\$ 7,224	\$ 4,211	\$ 3,917	\$ 3,256
Total deposits	\$ 433,255	\$ 371,493	\$ 391,940	\$ 402,176	\$ 426,560
Total shareholders' equity	\$ 38,231	\$ 35,437	\$ 37,139	\$ 35,852	\$ 31,137
Balance sheet (period average)					
Total assets	\$ 490,000	\$ 447,720	\$ 464,974	\$ 468,988	\$ 452,225
Total loans	\$ 354,482	\$ 355,416	\$ 353,384	\$ 335,226	\$ 302,596
Total deposits	\$ 403,896	\$ 382,279	\$ 403,772	\$ 415,700	\$ 403,818
Total shareholders' equity	\$ 43,839	\$ 37,343	\$ 37,041	\$ 33,682	\$ 29,548
Capital ratios					
Leverage ratio	7.9%	9.8%	10.0%	9.5%	8.5%
Tier 1 risk-based capital	10.4%	11.0%	11.6%	10.9%	10.3%
Total risk-based capital	11.6%	12.2%	12.7%	11.8%	11.1%
Asset quality ratios					
Nonperforming loans/total loans	4.30%	7.31%	0.75%	0.29%	0.52%
Nonperforming assets/total assets	4.84%	6.78%	0.70%	0.22%	0.36%
Allowance for loan losses/total loans	2.88%	1.97%	1.19%	1.10%	1.01%
Net loan charge-offs	\$ 12,156	\$ 1,587	\$ 506	\$ 339	\$ 566
Performance ratios					
(Loss) return on average assets	(1.87)%	0.07%	0.91%	1.11%	1.00%
(Loss) return on average common equity	(29.5)%	0.8%	11.4%	15.4%	15.2%

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(Loss) return on average equity	(20.9)%	0.8%	11.4%	15.4%	15.2%
Net interest margin	4.52%	4.99%	5.18%	5.32%	5.06%
Loans to Deposits	76.8%	98.5%	90.1%	88.2%	75.4%
Efficiency ratio	105.7%	81.4%	72.3%	66.1%	68.1%
Per share information					
Basic earnings (loss)	\$ (2.05)	\$ 0.06	\$ 0.85	\$ 1.04	\$ 0.92
Diluted earnings (loss)	\$ (2.05)	\$ 0.06	\$ 0.84	\$ 1.02	\$ 0.89
Common cash dividends	\$ 0.00	\$ 0.24	\$ 0.30	\$ 0.26	\$ 0.22
Dividend payout ratio	%	400%	35.3%	25.0%	23.9%
Book value per common share	\$ 5.58	\$ 7.42	\$ 7.63	\$ 7.14	\$ 6.26
Common shares outstanding at period end	4,776,339	4,775,339	4,869,130	5,023,205	4,976,654

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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 and consumer loans and, to a lesser extent, interest on investment securities, fees received in connection with servicing deposit and loan customers and fees from the sale of 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.

One of our strategic objectives is to expand our banking service activities to adjacent communities. In October, 2006 we opened a new Bank owned branch in Truckee, California. This replaced a much smaller leased facility. During the fourth quarter of 2006 we opened a commercial real estate loan office in Reno, Nevada. During the second quarter of 2007 we opened a branch in Redding, California and during the fourth quarter of 2007 we opened a government guaranteed lending office in Auburn, California.

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 represents our best estimate of losses inherent in the existing loan portfolio. The allowance for loan losses is increased by the provision for loan losses charged to expense and reduced by loans charged off, net of recoveries.

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 collectibility 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 determine the appropriate level of the allowance for loan losses, primarily on an analysis of the various components of the loan portfolio, including all significant credits on an individual basis. We segment the loan portfolio into as many components as practical. Each component has similar characteristics, such as risk classification, past due status, type of loan or lease, industry or collateral.

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. Write-downs to fair value at the time of transfer to OREO is 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.

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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.

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

Deferred income taxes reflect the estimated future tax effects of temporary differences between the reported amount of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws and regulations. We use an estimate of future earnings to support our position that the benefit of our deferred tax assets will be realized. A valuation allowance is recognized if, based on the weight of available evidence, management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized. If future income should prove non-existent or less than the amount of the deferred tax assets within the tax years to which they may be applied, the asset may not be realized and our net income will be reduced.

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

Stock-Based Compensation. Compensation cost is recognized for all stock based awards that vest subsequent to January 1, 2006 based on the grant-date fair value of the awards. We believe this is a critical accounting estimate since the grant-date fair value is estimated using the Black-Scholes-Merton option-pricing formula, which involves making estimates of the assumptions used, including the expected term of the option, expected volatility over the option term, expected dividend yield over the option term and risk-free interest rate. In addition, when determining the compensation expense to amortize over the vesting period, management makes estimates about the expected forfeiture rate of options.

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, 2009 and 2008 and for each of the three years in the period ended December 31, 2009. 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

Our Company has been affected by an economic downturn unprecedented in recent memory. Primarily related to significant declines in real estate values our provision for loan losses increased by \$9.9 million and we experienced a \$4.2 million increase in the provision for OREO losses. These items along with an \$895 thousand decrease in net interest income, an \$867 thousand increase in FDIC insurance premiums and a \$0.8 million increase in other items of non-interest expense were partially offset by a \$0.7 million increase in non-interest income. The result was a pretax loss of \$15.9 million for the year ended December 31, 2009. This compares to pretax income of \$92 thousand in 2008 and \$6.7 million in 2007. We recorded a benefit for income taxes of \$6.8 million in 2009 and \$212 thousand in 2008. Income tax expense was \$2.5 million in 2007. The Company recorded a net loss of \$9.1 million for the year ended December 31, 2009 down \$9.4 million from net income of \$304 thousand for the year ended December 31, 2008. Net income was \$4.2 million for the year ended December 31, 2007.

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Net income (loss) allocable to common shareholders declined from net income of \$304 thousand during the year ended December 31, 2008 to a net loss of \$9.8 million during 2009. Included in the 2009 loss was the net loss described above of \$9.1 million and an additional \$628 thousand which represents dividends paid and accrued and the discount amortized on preferred stock.

Most of the increase in the provision for loan losses can be attributed to declines in collateral value and increases in net charges-offs related to our real estate construction and land development loan portfolio. During 2009 we have significantly reduced our exposure to these loans as demonstrated by a decline in loan balances in this portfolio of \$35.7 million from \$73.8 million at December 31, 2008 to \$38.1 million at December 31, 2009.

Total assets at December 31, 2009 increased \$70.9 million, or 15.5% to \$528 million. Increases include \$40.7 million in cash and due from banks, \$49.6 million in investment securities, \$7.0 million in real estate and vehicles acquired through foreclosure and \$9.3 million in other assets, partially offset by a decline of \$35.7 million in net loans. The increase in investment securities relates to the purchase of securities issued by U.S. government agencies, while the increase in cash includes \$18.8 million in interest earning balances held at the Federal Reserve Bank of San Francisco (FRB). Net loans totaled \$323.4 million at December 31, 2009, down 9.9% from \$359.1 million at December 31, 2008. At December 31, 2009 investment securities totaled \$88.0 million compared to \$38.4 million at December 31, 2008.

Related to increases of \$33.5 million in interest-bearing demand accounts, \$24.4 million in time deposits, and \$5.0 million in money market accounts, slightly offset by declines of \$0.8 million in non-interest bearing demand deposits and \$0.3 million in savings accounts, deposits increased by \$61.8 million, or 16.6%, to \$433.3 million at December 31, 2009 from \$371.5 million at December 31, 2008. The Company has been successful in increasing its interest-bearing demand accounts as a result of a new interest bearing transaction account designed for local public agencies, which we have successfully marketed to several of the municipalities in our service area. Time deposits benefited from a new a promotional time deposit product we began offering in June, 2009. This product had an 18 month term and a 2% rate.

Total borrowings increased from \$34 million at December 31, 2008 to \$40 million at December 31, 2009. The Company chose to borrow \$10 million in a two year term FHLB advance and \$10 million in a three year term FHLB advance to take advantage of favorable interest rates. Other borrowings at December 31, 2009 were \$20 million in a six month FHLB advance which matured on January 19, 2010. Borrowings at December 31, 2008 consisted of \$34 million in overnight FHLB advances.

Shareholders' equity as of December 31, 2009 increased by \$2.8 million to \$38.2 million up from \$35.4 million as of December 31, 2008. This increase is related to the issuance of \$11.9 million in Preferred Stock, Series A to the United States Department of Treasury (Treasury) under the Capital Purchase Program, partially offset by our 2009 net loss.

The return (loss) on average assets was (1.87) % for 2009, down from 0.07% for 2008. The return (loss) on average common equity was (29.5) % for 2009, down from 0.8% for 2008.

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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,								
	2009			2008			2007		
	Average balance	Interest income/expense	Rates earned/paid	Average balance	Interest income/expense	Rates earned/paid	Average balance	Interest income/expense	Rates earned/paid
	<i>(dollars in thousands)</i>								
Assets									
Interest bearing deposits	\$ 6,298	\$ 15	0.24%	\$	\$	%	\$	\$	%
Federal funds sold	12			118	3	2.54	3,517	171	4.86
Investment securities ⁽¹⁾	64,047	2,163	3.38	46,658	1,887	4.04	62,690	2,404	3.83
Total loans ⁽²⁾⁽³⁾	354,482	20,658	5.83	355,416	23,550	6.63	353,384	27,709	7.84
Total earning assets	424,839	22,836	5.38%	402,192	25,440	6.33%	419,591	30,284	7.22%
Cash and due from banks	27,372			12,174			12,850		
Other assets	37,789			33,354			32,533		
Total assets	\$ 490,000			\$ 447,720			\$ 464,974		
Liabilities and shareholders equity									
Interest bearing demand deposits	\$ 98,394	671	0.68%	\$ 73,338	548	0.75%	\$ 77,254	1,335	1.73%
Money market deposits	41,844	346	0.83	37,626	312	0.83	39,431	327	0.83
Savings deposits	50,286	90	0.18	48,573	161	0.33	50,448	245	0.49
Time deposits	105,313	2,062	1.96	110,743	3,501	3.16	121,808	5,304	4.35
Short-term borrowings	24,292	80	0.33	11,857	202	1.70	8,735	467	5.35
Long-term borrowings	1,589	27	1.70						
	10,310	371	3.60	10,310	623	6.04	10,310	835	8.10

Junior subordinated debentures									
Other	212	8	3.77	309	17	5.50	303	23	7.59
Total interest bearing liabilities	332,240	3,655	1.10%	292,756	5,364	1.83%	308,289	8,536	2.77%
Noninterest bearing demand deposits	108,059			111,999			114,831		
Other liabilities	5,862			5,622			4,813		
Shareholders equity	43,839			37,343			37,041		
Total liabilities and shareholders equity	\$ 490,000			\$ 447,720			\$ 464,974		
Net interest income		\$ 19,181			\$ 20,076			\$ 21,748	
Net interest spread ⁽⁴⁾			4.28%			4.50%			4.45%
Net interest margin ⁽⁵⁾			4.52%			4.99%			5.18%

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

(2) Average nonaccrual loan balances of \$25.1 million for 2009, \$5.2 million for 2008 and \$1.7 million for 2007 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 \$214,000, \$288,000 and \$360,000 for 2009, 2008 and 2007, 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:

	2009 compared to 2008				2008 compared to 2007			
	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
	<i>(dollars in thousands)</i>							
Interest-earning assets:								
Interest bearing deposits	\$	\$	\$ 15	\$ 15	\$	\$	\$	\$
Federal funds sold	(3)	(3)	3	(3)	(165)	(82)	79	(168)
Investment securities	703	(311)	(116)	276	(615)	131	(33)	(517)
Loans	(62)	(2,838)	8	(2,892)	159	(4,294)	(24)	(4,159)
Total interest income	638	(3,152)	(90)	(2,604)	(621)	(4,245)	22	(4,844)
Interest-bearing liabilities:								
Interest bearing demand deposits	187	(48)	(16)	123	(68)	(758)	39	(787)
Money market deposits	35		(1)	34	(15)			(15)
Savings deposits	6	(74)	(3)	(71)	(9)	(78)	3	(84)
Time deposits	(172)	(1,333)	66	(1,439)	(482)	(1,453)	132	(1,803)
Short-term borrowings	212	(163)	(171)	(122)	167	(318)	(114)	(265)
Long-term borrowings			27	27				
Junior subordinated debentures		(252)		(252)		(212)		(212)
Other borrowings	(5)	(5)	1	(9)		(6)		(6)
Total interest expense	263	(1,875)	(97)	(1,709)	(407)	(2,825)	60	(3,172)
Net interest income	\$ 375	\$ (1,277)	\$ 7	\$ (895)	\$ (214)	\$ (1,420)	\$ (38)	\$ (1,672)

(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.

2009 compared to 2008. Net interest income is the difference between interest income and interest expense. Net interest income, on a nontax-equivalent basis, was \$19.2 million for the year ended December 31, 2009, a decline of \$895 thousand, or 4.5%, from \$20.1 million for 2008. The decline in interest income and expense includes the affect of a decline in market interest rates during the comparison periods as illustrated by the decline in the average prime interest rate from 5.09% during 2008 to 3.25% for 2009. Additionally, interest earned on the Company's loan portfolio declined related to an increase in average nonaccrual loans from \$5.2 million during the 2008 period to \$25.1 million during the year ended December 31, 2009.

Overall changes in net interest income are primarily a result of a decrease in loan interest income, largely due to the decline in yields earned, partially offset by an increase in interest on investments securities, related to an increase in average investment securities outstanding and decreases in interest expense on deposits, short-term borrowings and junior subordinated debentures primarily due to the decline in the average rates paid.

Interest income decreased \$2.6 million, or 10.2%, to \$22.8 million for the year ended December 31, 2009. Interest and fees on loans decreased by \$2.9 million from \$23.6 million for the year ended December 31, 2008 to \$20.7 million for 2009. The average loan balances were \$354.5 million for 2009, down \$0.9 million from the \$355.4 million for 2008. The average yields on loans were 5.83% for 2009 down from the 6.63% for 2008. In addition to the decline in yield related to a decline in market interest rates, loan yields for 2009 reflect an increase in the balance of average nonaccrual loans.

Interest on investment securities increased by \$276 thousand, as a decrease in yield of 66 basis points was offset by an increase in average investment securities of \$17.4 million. The decrease in rate for 2009 relates to the purchase of securities during the twelve months ended December 31, 2009 and the maturity of higher rate securities.

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As a result of the declining rate environment interest expense decreased \$1.7 million to \$3.7 million for the year ended December 31, 2009, from \$5.4 million for 2008. The decrease in interest expense was primarily attributed to rate decreases on time deposits and, to a lesser extent, rate decreases on interest-bearing transaction accounts, savings and money market deposits, short-term borrowings and junior subordinated debentures. The decrease in expense related to declining rates was slightly offset by increases in the average balances of interest bearing demand deposits and short-term borrowings.

For the year ended December 31, 2009 compared to 2008, the Company's average rate paid on time deposits decreased 120 basis points to 1.96% from 3.16%. This decrease primarily relates to a decline in market rates in the Company's service area. During the same period the average balances of time deposits declined by \$5.4 million to \$105.3 million. Interest expense on time deposits declined by \$1.4 million from \$3.5 million during 2008 to \$2.1 million during the twelve months ended December 31, 2009.

Interest expense on interest-bearing demand accounts increased by \$123 thousand related to an increase in the average balance of these deposits from \$73.3 million during 2008 to \$98.4 million during 2009 partially offset by a decrease in the average rate paid on these accounts from 0.75% during 2008 to 0.68% during the twelve months ended December 31, 2009. The increase in interest-bearing demand accounts primary relates to a new interest bearing transaction account designed for local public agencies, which we have successfully marketed to several of the municipalities in our service area. Interest expense on money market accounts increased by \$34 thousand related to an increase in the average balance. The rate paid on these accounts was 0.83% during both periods as a decline in market interest rates was offset by the introduction of a new corporate sweep product which offers a tiered rate structure that rewards customers with a higher rate for maintaining larger balances. Interest on savings deposits declined by \$71 thousand related to a decline in rate paid from 0.33% during 2008 to 0.18% during 2009.

Interest on short-term borrowings decreased by \$122 thousand as a decline in the rate paid on these borrowings of 137 basis points was partially offset by an increase of \$12.4 million in average balance. Interest expense paid on junior subordinated debentures, which fluctuates with changes in the 3-month London Interbank Offered Rate (LIBOR) rate, decreased by \$252 thousand during 2009 as a result of a decrease in the 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 2009 decreased 47 basis points to 4.52%, from 4.99% for 2008.

2008 compared to 2007. Net interest income, on a nontax-equivalent basis, was \$20.1 million for the year ended December 31, 2008, a decline of \$1.7 million, or 7.7%, from \$21.8 million for 2007. The decline in interest income and expense is primarily related to market interest rate changes during the comparison periods reflective of the 400 basis point decline in Federal fund rates during 2008. In addition, the Company's cost of funds has benefited from the maturity of higher rate time deposits during 2008.

Overall changes in net interest income are primarily a result of the decrease in loan interest income, primarily due to the decline in yields earned, and the decrease in interest on investments securities, primarily due to the decrease in average investment securities outstanding, offset by the decreases in interest expense on deposits, short-term borrowings and junior subordinated debentures primarily due to the decline in the average rates paid.

Interest income decreased \$4.8 million, or 16.0%, to \$25.4 million for the year ended December 31, 2008. Interest and fees on loans decreased by \$4.2 million from \$27.7 million for the year ended December 31, 2007 to \$23.5 million for 2008. The average loan balances were \$355.4 million for 2008, up \$2.0 million from the \$353.4 million for 2007. The average yields on loans were 6.63% for 2008 down from the 7.84% for 2007. In addition to the decline in yield related to a decline in market interest rates, the loan yields for 2008 reflects the impact of an increase in forgone interest on nonaccrual loans from \$161 thousand during 2007 to \$576 thousand during 2008.

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Interest on investment securities decreased by \$517 thousand, as a slight increase in yield of 21 basis points was offset by a decline in the average balance of investment securities of \$16.0 million. The increase in rate during 2008 primarily relates to scheduled repayments of lower rate securities. Interest on Federal funds sold declined by \$168 thousand related both to a decline in the average balance outstanding and a decline in the average rate earned.

As a result of the declining rate environment interest expense decreased \$3.2 million to \$5.3 million for the year ended December 31, 2008, from \$8.5 million for 2007. The decrease in interest expense was primarily attributed to rate decreases on time deposits and interest bearing demand deposits and, to a lesser extent, rate decreases on savings deposits, short-term borrowings and junior subordinated debentures. During 2007, rather than increasing the rates paid on our lower cost interest bearing transaction, money market and savings accounts to attract deposits and thereby increasing the rate paid on the entire balance of these accounts, the Company chose to increase its level of time deposits by offering certain short-term promotional certificates of deposit which paid a higher rate than our standard time deposits. During 2008 we allowed these higher rate promotional time deposits to mature and increased our level of short-term borrowings which offered favorable interest rates in comparison to rates we would have had to pay to attract additional time deposits.

For the year ended December 31, 2008 compared to 2007, the Company's average rate paid on time deposits decreased 119 basis points to 3.16% from 4.35%. This decrease includes a decline in market rates in the Company's service area and the effect of our discontinuing the promotional certificate of deposit program.

Interest expense on interest-bearing demand accounts declined by \$787 thousand primarily related to a decline in the average rate paid on these accounts from 1.73% in 2007 to 0.75% in 2008. Interest expense on money market accounts declined by \$15 thousand related to a decline in the average balance. The rate paid on these accounts was 0.83% during both periods as a decline in market interest rates was offset by the introduction of a new corporate sweep product which offers a tiered rate structure that rewards customers with a higher rate for maintaining larger balances. Interest on short-term borrowings decreased by \$265 thousand as a decline in the rate paid on these borrowings was partially offset by an increase in average balance. Interest expense paid on junior subordinated debentures, which fluctuates with changes in the 3-month London Interbank Offered Rate (LIBOR) rate, decreased by \$212 thousand during 2008 as a result of a decrease in the LIBOR rate.

As a result of the changes noted above, the net interest margin for 2008 decreased 19 basis points to 4.99%, from 5.18% for 2007.

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 collectibility 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.

In response to an increase in the level of net loan charge-offs and our evaluation of the adequacy of the allowance for loan losses in the current economic environment, particularly related to the decline in real estate values, we increased our provision for loan losses. Net charge-offs totaled \$12.2 million during 2009, however \$10 million of this amount was related to construction and land development loans. 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

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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. Management relies heavily on recent loss experience in determining risk in the category which it believes provides a more accurate gauge of actual risk given the negative trends in the current economic cycle. Real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The Company has significantly reduced its exposure to these loans as demonstrated by a decline in loan balances in this portfolio of \$35.7 million from \$73.8 million at December 31, 2008 to \$38.1 million at December 31, 2009.

The provision for loan losses increased from \$800 thousand during 2007 to \$4.6 million during 2008 and was \$14.5 million during the year ended December 31, 2009. The Company has increased its level of allowance for loan losses to total loans from 1.97% at December 31, 2008 to 2.88% at December 31, 2009 and has increased its allowance for loan losses from \$7.2 million to \$9.6 million for the same periods. Net charge-offs as a percentage of average loans increased to 3.43% for 2009 from 0.45% for 2008 and 0.14% for 2007. Net charge-offs on construction and land developments loans as a percentage of average loans increased to 2.94% for 2009 from 0.15% for 2008. The Company has made progress, during 2009, in decreasing its level of nonperforming loans. After increasing from \$2.6 million at December 31, 2007 to \$26.7 million at December 31, 2008 nonperforming loans declined to \$14.3 million at December 31 2009. 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. See the section **Analysis of Asset Quality and Allowance for Loan Losses** for further discussion of loan quality trends and the provision for loan losses.

Non-Interest Income

The following table sets forth the components of non-interest income for the years ended December 31, 2009, 2008 and 2007.

	Years Ended December 31,			Change during Year	
	2009	2008	2007	2009	2008
	<i>(dollars in thousands)</i>				
Service charges on deposit accounts	\$ 3,796	\$ 3,951	\$ 3,806	\$ (155)	\$ 145
Gain on sale of loans, net	593	111	47	482	64
Earnings on bank owned life insurance policies	434	421	415	13	6
Merchant processing	282	286	282	(4)	4
Loan servicing fees	139	96	140	43	(44)
Customer service fees	121	114	119	7	(5)
Investment services	81	125	162	(44)	(37)
Safe deposit box and night depository income	68	67	67	1	
Official check fees	17	93	157	(76)	(64)
Federal Home Loan Bank dividends	4	105	109	(101)	(4)
Impairment loss on investment security		(415)		415	(415)
Other income	217	137	144	80	(7)
Total non-interest income	\$ 5,752	\$ 5,091	\$ 5,448	\$ 661	\$ (357)

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2009 compared to 2008. During 2009, total non-interest income increased by \$661 thousand or 13%, to \$5.8 million, up from \$5.1 million from the comparable period in 2008. This increase was primarily related to two items: (i) during the 2008 period non-interest income was adversely affected by an other than temporary impairment write down of \$415 thousand on a security issued by Lehman Brothers Holdings Inc., which filed for Chapter 11 bankruptcy on September 15, 2008 and; (ii) during 2009 we increased our gain on sale of SBA government guaranteed loans by \$482 thousand. In addition, other income increased by \$80 thousand and loan servicing fees increased by \$43 thousand.

Gains on loan sales are related to the sale of the guaranteed portion of SBA loans. The increase in loan sale gains include an increase in loans sold from \$4.3 million during the year ended December 31, 2008 to \$10.8 million during 2009, increases in the market price of SBA guaranteed loans and an increase, during 2009, in the percentage of each loan that is guaranteed by the SBA.

Partially offsetting these increases in income were declines in service charges, investment services income, official check fees and FHLB dividends. Service charge income decreased by \$155 thousand related to a decrease in NSF/overdraft income. Investment services income decreased by \$44 thousand; however, the Company offset this decrease by a decrease in staffing dedicated to this department. The Company attributes these decreases primarily to the economic conditions present during 2009. Official checks fees declined by \$76 thousand. Official checks fees represent fees paid by a third party processor for the processing of our cashier and expense checks. These fees are indexed to the federal funds rate and the decrease in income from this item is primarily related to the decline in the federal funds rate during 2009. Additionally, during 2008 the processor changed the fee structure further reducing fees that we earn under this relationship. The FHLB paid only one dividend totaling \$4 thousand during 2009 compared to four quarterly dividends totaling \$105 thousand during 2008.

2008 compared to 2007. During 2008, total non-interest income decreased by \$357 thousand or 7%, to \$5.1 million, down from \$5.4 million from the comparable period in 2007. This decrease was primarily related to a write down on a security issued by Lehman Brothers Holdings Inc. Due to the significant decline in the price of this security following its bankruptcy filing the Company recorded an other than temporary impairment write down of \$415 thousand. Partially offsetting this decrease were increases in service charges and gains on loan sales.

Service charge income increased by \$145 thousand primarily related to an increase in monthly service charges on non-interest bearing transaction accounts. Gains on the sale of loans, which increased by \$64 thousand, relate to the sale of SBA government guaranteed loans and reflects an increase in staffing levels in our government guaranteed lending operations. Partially offsetting these items were decreases in official check fees, loan servicing fees and investment services income.

Official checks fees declined by \$64 thousand. Official checks fees represent fees paid by a third party processor for the processing of our cashier and expense checks. These fees are indexed to the federal funds rate and the decrease in income from this item is primarily related to the decline in the federal funds rate during 2008. Additionally, during 2008 the processor changed the fee structure further reducing fees that we earn under this relationship. Smaller decreases were experienced in loan servicing income which declined by \$44 thousand and investment services revenue which declined \$37 thousand.

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The following table sets forth the components of other non-interest expense for the years ended December 31, 2009, 2008 and 2007.

	Years Ended December 31,			Change during Year	
	2009	2008	2007	2009	2008
	<i>(dollars in thousands)</i>				
Salaries and employee benefits	\$ 11,054	\$ 10,884	\$ 11,200	\$ 170	\$ (316)
Occupancy and equipment	3,759	3,838	3,552	(79)	286
Provision for OREO losses	4,800	618		4,182	618
FDIC insurance	1,125	258	48	867	210
Outside service fees	892	735	671	157	64
Professional fees	789	688	738	101	(50)
Loan collection costs	399	205	154	194	51
Telephone and data communications	392	400	362	(8)	38
Business development	333	467	530	(134)	(63)
OREO costs	370	175	38	195	137
Advertising and promotion	327	448	520	(121)	(72)
Director compensation and retirement	293	323	349	(30)	(26)
Armored car and courier	281	289	279	(8)	10
Postage	207	208	242	(1)	(34)
Stationery and supplies	183	236	278	(53)	(42)
Core deposit intangible amortization	173	216	301	(43)	(85)
Loss on sale of OREO	158			158	
Insurance	142	235	177	(93)	58
Other operating expense	677	252	232	425	20
Total non-interest expense	\$ 26,354	\$ 20,475	\$ 19,671	\$ 5,879	\$ 804

2009 compared to 2008. During the year ended December 31, 2009, total non-interest expense increased by \$5.9 million, or 29%, to \$26.4 million, up from \$20.5 million for the comparable period in 2008. This increase in non-interest expense was primarily the result of an increase in the provision for OREO losses of \$4.2 million and an increase in FDIC insurance assessments of \$867 thousand. Other significant increases included \$170 thousand in salaries and employee benefits, \$157 thousand in outside service fees, \$101 thousand in professional fees, \$194 thousand in loan collection costs, \$195 thousand in OREO costs, \$158 thousand in losses on the sale of OREO and \$425 thousand in other expense. These items were partially offset by reductions in other costs, the three largest of which were advertising and shareholder relations, business development and insurance expense.

A valuation allowance for losses on other real estate is maintained to provide for declines in value. The provision for OREO losses for the year ended December 31, 2009 totaled \$4.8 million which represents significant declines in the value of several properties. At December 31, 2009 OREO consisted of twenty-nine properties with a total fair value, which includes a \$5.1 million valuation allowance, of \$11.2 million. At December 31, 2008 OREO consisted of nineteen properties with a fair value of \$4.1 million.

During 2009 the FDIC increased regular assessments and implemented a special assessment resulting in a significant increase in FDIC assessments. Additionally, during the first quarter of 2008 the Company was able to use its remaining credit balance with the FDIC to offset insurance premium billings; however, by the end of the first quarter of 2008 the credit balance had been fully utilized. The Company is currently forecasting elevated FDIC insurance

premiums for next several years.

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Salaries and other employee benefits increased by \$170 thousand primarily related to a decrease in the deferral of loan origination costs. Salary expense increased by \$21 thousand as an increase in salary expense of \$296 thousand related to our government guaranteed lending operations was mostly offset by reductions in staffing in other areas including our Reno loan production office and our branch network. Related to a decrease in loan production, the deferral of loan origination cost, which reduces salary and benefits cost, declined by \$160 thousand.

During the fourth quarter of 2009 the Company outsourced the oversight of its computer network, resulting in a reduction in information technology staffing. The cost of this outsourcing is included in the increase in outside services fees. In addition, during 2009 we implemented an outsourced online banking product which also increased outside service fees.

Consistent with the increase in nonperforming loans and assets during the period (See the section Analysis of Asset Quality and Allowance for Loan Losses) loan collection costs and OREO expenses increased by \$389 thousand. OREO costs which include the cost of holding and maintaining foreclosed real estate increased by \$195 thousand to \$370 thousand while loan collection costs increased by \$194 thousand to \$399 thousand. Losses incurred on the sale of OREO totaled \$158 thousand and relate to the sale of nine properties. Proceeds received on sale of these properties totaled \$2.0 million.

The increase in other expense, which totaled \$425 thousand, is primarily related to nonrecurring expense items, the largest of which totaled \$140 thousand.

We implemented cost control initiatives which, among other things, have resulted in savings in advertising, shareholder relation costs and business development costs. These cost savings totaled \$255 thousand during 2009 when compared to 2008. We reduced our shareholder expense by eliminating the glossy section of our annual report. Business development costs declined as we reduced certain employee travel and relationship-building initiatives which generated an annual savings of approximately \$75 thousand.

During the first quarter of 2009 our Chief Information and Technology officer retired from the Company. Because his retirement took place prior to the age of sixty-five he forfeited his benefits under his company provided split dollar life insurance plan. To reflect this forfeiture we recorded a one-time reduction in insurance expense totaling \$83 thousand. **2008 compared to 2007.** During 2008, total non-interest expense increased \$804 thousand, or 4%, to \$20.5 million, up from \$19.7 million for the comparable period in 2007. The increase in non-interest expense was primarily the result of increases in occupancy and equipment costs, loan expenses, FDIC insurance costs and the provision for OREO losses. These items were partially offset by declines in salaries and employee benefits, reductions in professional fees, business development and advertising costs, and a reduction in core deposit intangible amortization. The largest single factor resulting in the increase in non-interest expense was a \$618 thousand provision for losses on OREO. We experienced a decline in the fair value of our foreclosed real estate holdings and to reflect this decline we established a valuation allowance for these properties through the recording of a \$618 thousand provision for losses on OREO properties.

The increase in occupancy and equipment costs primarily relates to costs associated with our Redding, California branch. We initially opened this branch in a small temporary facility and in July 2008 we relocated to our much larger permanent leased facility which is located in Redding's commercial district, across the street from City Hall. Consistent with the increase in nonperforming loans and assets during the period loan collection costs increased by \$51 thousand to \$205 thousand and OREO expenses increased by \$137 thousand from \$38 thousand during 2007 to \$175 thousand for the year ended December 31, 2008. FDIC insurance expense increased by \$210 thousand. During 2007 the Company was able to use its remaining credit balance with the FDIC to offset insurance premium billings; however by the end of the first quarter of 2008 the credit balance had been fully utilized.

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Salaries and employee benefit expenses decreased \$316 thousand, or 3%, from the year ended December 31, 2007. The largest components of this decrease were a \$330 thousand decline in salary continuation plan expense and a \$224 thousand decline in bonus expense. These items were partially offset by an increase in salary expense of \$315 thousand.

The Company provides retirement benefits to its executive officers in the form of salary continuation plans and split dollar life insurance agreements. The purpose of these agreements is to provide a special incentive to the experienced executive officer to continue employment with the Company on a long-term basis. These costs were abnormally high during 2007 as they included a one-time expense of \$194 thousand reflecting the announced early retirement of our Chief Information/Technology officer.

The decline in bonus expense is consistent with a decline in net income during the period as a significant portion of our bonus plans are tied to or directly influenced by the level of net income including return on average equity, return on average assets and earnings per share. The decline in net income during the period resulted in an absence of bonuses earned from this portion of our bonus plans. Bonus expense recorded for 2008 was related to factors not directly related to net income such as loan production and deposit growth.

Salaries costs increased by \$315 thousand which included annual merit increases as well as expansion of our government guaranteed lending activities and an increase in staffing levels at our Redding, California branch.

We have focused our attention on cost control initiatives and have been successful in several areas. We reduced professional fees by \$50 thousand and reduced business development and advertising costs by \$135 thousand. During the 2007 period professional fees included consulting costs associated with an outside evaluation of our core banking software requirements, other technology planning costs and costs associated with a strategic planning initiative. Similar costs were not incurred during the 2008 period. The decrease in business development and advertising costs resulted from reductions in our marketing budget, promotional materials, and a decrease in seminar and conference costs.

Core deposit intangible amortization declined by \$85 thousand as a portion of this asset is now fully amortized. The remaining asset is scheduled to amortize at the rate of \$173 thousand per year until October, 2013.

Provision for income taxes. The Company recorded an income tax benefit of \$6.8 million, or 42.6% of pre-tax loss for the year ended December 31, 2009. During 2008 the Company recorded an income tax benefit of \$212 thousand as tax exempt income exceeded pretax income.

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.

As part of its analysis, the Company considered the following positive evidence:

The Company's 2009 net loss was largely attributable to losses on its Construction and Land Development portfolio that represented approximately 80% of net charge-offs during the year ended December 31, 2009. This portfolio has significantly decreased during the current year and the Company is not growing the portfolio.

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The Company's 2009 net loss was also attributable to large write-downs in Construction and Land Development real estate owned which represented the majority of its provision for losses on other real estate during 2009. Given that the Construction and Land Development REO is valued significantly below the original appraised value as of December 31, 2009, management does not anticipate significant additional declines in future periods.

The Company has a long history of earnings profitability.

The Company is projecting future taxable and book income will be generated by operations.

The size of loan credits in the Company's pipeline of potential problem loans has significantly decreased.

As part of its analysis, the Company considered the following negative evidence:

The Company recorded a large net loss in 2009 and is in a cumulative loss position for the current and preceding two years.

The Company did not meet its financial projections in 2009 or 2008.

Based upon our analysis of available evidence, we have determined that it is more likely than not that all of our deferred income tax assets as of December 31, 2009 and 2008 will be fully realized and therefore no valuation allowance was recorded.

Financial Condition

Loan Portfolio. 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 commercial 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.

The Company's largest lending categories are real estate mortgage loans, consumer and real estate construction and land development loans. These categories accounted for approximately 48.5%, 16.4% and 11.4%, respectively of the Company's total loan portfolio at December 31, 2009, and approximately 41.5%, 16.9% and 20.2%, respectively of the Company's total loan portfolio at December 31, 2008. 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 reflects management's efforts to reduce its exposure to construction and land development loans in 2009 due to the severe valuation decrease in the real estate market.

The Company's real estate related loans, including real estate mortgage loans, real estate construction loans, consumer equity lines of credit, and agricultural loans secured by real estate comprised 77% and 75% of the total loan portfolio at December 31, 2009 and 2008. Moreover, the business activities of the Company currently are focused in the California counties of Plumas, Nevada, Placer, Lassen, Modoc, Shasta, 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.

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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. At December 31, 2009 and 2008, approximately 68% and 67%, respectively, of the Company's loan portfolio was comprised of variable rate loans. 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. 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 \$42 million and \$36 million at December 31, 2009 and 2008, respectively.

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

	At December 31,				
	2009	2008	2007	2006	2005
	<i>(dollars in thousands)</i>				
Real estate mortgage	\$ 161,397	\$ 151,943	\$ 128,357	\$ 116,329	\$ 110,686
Real estate construction	38,061	73,820	76,478	75,930	56,370
Commercial	37,056	42,528	39,584	36,182	42,252
Consumer	54,442	61,706	72,768	90,694	81,320
Agriculture	41,722	36,020	35,762	35,577	31,018
Total loans	332,678	366,017	352,949	354,712	321,646
Less:					
Deferred costs	(298)	(279)	(564)	(1,182)	(766)
Allowance for loan losses	9,568	7,224	4,211	3,917	3,256
Net loans	\$ 323,408	\$ 359,072	\$ 349,302	\$ 351,977	\$ 319,156

The following table sets forth the maturity of gross loan categories as of December 31, 2009. Also provided with respect to such loans are the amounts due after one year, classified according to sensitivity to changes in interest rates:

	Within	After One	After	Total
	One Year	Through Five	Five Years	
	<i>(dollars in thousands)</i>			
Real estate mortgage	\$ 20,617	\$ 30,097	\$ 110,683	\$ 161,397
Real estate construction	19,011	7,861	11,189	38,061
Commercial	11,947	22,315	2,794	37,056
Consumer	9,422	15,801	29,219	54,442
Agriculture	18,585	9,407	13,730	41,722
Total	\$ 79,582	\$ 85,481	\$ 167,615	\$ 332,678
Loans maturing after one year with:				
Fixed interest rates		\$ 27,428	\$ 58,294	\$ 85,722
Variable interest rates		58,053	109,321	167,374
Total		\$ 85,481	\$ 167,615	\$ 253,096

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 Board of Directors, through the loan committee, reviews the asset quality of new and criticized 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.

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The Company has implemented a Management Asset Resolution Committee (MARC) to develop an action plan to significantly reduce nonperforming loans. It consists of members of executive management, credit administration management and the Board of Directors, and the activities are governed by a formal written charter. The MARC meets semi-monthly and reports to the Board's Loan Committee.

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, 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.

Related to the severe economic downturn and the resulting decline in real estate values the Company's charge-offs increased dramatically during 2009. Net charge-offs during the year ended December 31, 2009 totaled \$12,156 thousand, or 3.43% of average loans, compared to \$1,587 thousand, or 0.45% of average loans for 2008 and \$506 thousand, or 0.14% of average loans for 2007. The allowance for loan losses stood at 2.88% of total loans as of December 31, 2009, versus 1.97% of total loans as of December 31, 2008.

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 loans. The adequacy of the allowance for loan losses is based upon management's continuing assessment of various factors affecting the collectibility 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 collectibility 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.

The federal financial regulatory agencies in December 2006 issued a new interagency policy statement on the allowance for loan and lease losses along with supplemental frequently asked questions. When determining the adequacy of the allowance for loan losses, the Company follows these guidelines. The policy statement revises and replaces a 1993 policy statement on the allowance for loan and lease losses. The agencies issued the revised policy statement in view of today's uncertain economic environment and the presence of concentrations in untested loan products in the loan portfolios of insured depository institutions. The policy statement has also been revised to conform with accounting principles generally accepted in the United States of America (GAAP) and post-1993 supervisory guidance. The policy statement reiterates that each institution has a responsibility for developing, maintaining and documenting a comprehensive, systematic, and consistently applied process appropriate to its size and the nature, scope, and risk of its lending activities for determining the amounts of the allowance for loan and lease losses and the provision for loan and lease losses and states that each institution should ensure controls are in place to consistently determine the allowance for loan and lease losses in accordance with GAAP, the institution's stated policies and procedures, management's best judgment and relevant supervisory guidance.

The policy statement also restates that insured depository institutions must maintain an allowance for loan and lease losses at a level that is appropriate to cover estimated credit losses on individually evaluated loans determined to be impaired as well as estimated credit losses inherent in the remainder of the loan and lease portfolio, and that estimates of credit losses should reflect consideration of all significant factors that

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affect the collectibility of the portfolio as of the evaluation date. The policy statement states that prudent, conservative, but not excessive, loan loss allowances that represent management's best estimate from within an acceptable range of estimated losses are appropriate. In addition, the Company incorporates the Securities and Exchange Commission Staff Accounting Bulletin No. 102, which represents the SEC staff's view related to methodologies and supporting documentation for the Allowance for Loan and Lease Losses that should be observed by all public companies in complying with the federal securities laws and the Commission's interpretations.

The Company's methodology for assessing the adequacy of the allowance for loan losses consists of several key elements, which include but are not limited to:

- specific allocation determined in accordance with ASC Topic 310 Receivables (formerly FAS 114, *Accounting for Impairment of a loan*) based on probable losses on specific loans.

- general reserves determined in accordance with guidance in ASC Topic 450 Contingencies (formerly SFAS No. 5, *Accounting for Contingencies*), based on historical loan loss experience adjusted for other qualitative risk factors both internal and external to the Company.

Specific allocations are established based on management's periodic evaluation of loss exposure inherent in classified, impaired, and other loans in which management believes that the collection of principal and interest under the original terms of the loan agreement are in question. For purposes of this analysis, classified loans are grouped by internal risk classifications which are special mention, substandard, doubtful, and loss. Special mention loans are currently performing but are potentially weak, as the borrower has begun to exhibit deteriorating trends, which if not corrected, could jeopardize repayment of the loan and result in further downgrade. Substandard loans have well-defined weaknesses which, if not corrected, could jeopardize the full satisfaction of the debt. A loan classified as doubtful has critical weaknesses that make full collection of the obligation improbable. Classified loans, as defined by the Company, include loans categorized as substandard and doubtful. Loans classified as loss are immediately charged off.

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 on the internal risk grade of those loans and may be adjusted for significant factors that, in management's judgment, affect the collectibility of the portfolio as of the evaluation date. The formula allocation analysis incorporates loan losses over the past seven years adjusted for changes in the business cycle. Loss factors are adjusted to recognize and quantify the estimated loss exposure resulting from changes in market conditions and trends in the Company's loan portfolio.

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.

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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.

	At December 31,				
	2009	2008	2007	2006	2005
	<i>(dollars in thousands)</i>				
Balance at beginning of period	\$ 7,224	\$ 4,211	\$ 3,917	\$ 3,256	\$ 2,722
Charge-offs:					
Commercial and agricultural	663	477	83	126	297
Real estate mortgage	1,145	95			
Real estate construction	10,133	522	46		
Consumer	559	689	657	519	442
Total charge-offs	12,500	1,783	786	645	739
Recoveries:					
Commercial and agricultural	18	11	53	46	21
Real estate mortgage	8	14			
Real estate construction	90				
Consumer	228	171	227	260	152
Total recoveries	344	196	280	306	173
Net charge-offs	12,156	1,587	506	339	566
Provision for loan losses	14,500	4,600	800	1,000	1,100
Balance at end of period	\$ 9,568	\$ 7,224	\$ 4,211	\$ 3,917	\$ 3,256
Net charge-offs during the period to average loans	3.43%	0.45%	0.14%	0.10%	0.19%
Allowance for loan losses to total loans	2.88%	1.97%	1.19%	1.10%	1.01%

The increase in the allowance for loan losses from December 31, 2008 is attributable to a \$1.2 million increase in specific reserves related to impaired loans from by \$3.1 million at December 31, 2008 to \$4.3 million at December 31, 2009 and a \$1.2 million increase in general reserves. General reserves totaled \$5.3 million at December 31, 2009 and \$4.1 million at December 31, 2008. As a percentage of total loans general reserves increased from 1.12% at December 31, 2008 to 1.59% at December 31, 2009.

Charge-offs totaled \$12.5 million of which \$10.1 million was related to our real estate construction and land development portfolio. We do not expect a similar level of losses in 2010 because in 2009 we dealt aggressively with our problem real estate loans as evidenced by a decrease in nonperforming loans from \$26.7 million at December 31, 2008 to \$14.3 million at December 31, 2009. In addition, we reduced our exposure to construction and land development loans as our construction and land development portfolio decreased by \$35.7 million from \$73.8 million at December 31, 2008 to \$38.1 million at December 31, 2009. As a result, we currently anticipate that charge-offs could range from approximately \$4 million to \$7 million in 2010, the largest part of which are anticipated to be related to real estate loans and consistent with 2009 activity within the real estate category most of the charge-offs are expected to be associated with construction and land development loans. For other categories of loans we expect charge-offs to be similar to 2009 activity. However, given the lack of stability in the real estate market and the recent volatility in charge-offs, there can be no assurance that charge offs of loans in future periods will not increase or

decrease from this estimate.

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

Impaired loans are measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. The amount of impaired loans is not directly comparable to the amount of nonperforming loans disclosed later in this section. The primary difference between impaired loans and nonperforming loans is that impaired loan recognition considers not only loans 90 days or more past due, restructured loans and nonaccrual loans but also may include identified problem loans other than delinquent loans where it is considered probable that we will not collect all amounts due to us (including both principal and interest) in accordance with the contractual terms of the loan agreement.

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The following table sets forth the amount of the Company's nonperforming assets as of the dates indicated. Loans restructured and in compliance with modified terms totaled \$3.4 million at December 31, 2009. There were no troubled debt restructurings at December 31, 2008, 2007, 2006 or 2005.

	At December 31,				
	2009	2008	2007	2006	2005
	<i>(dollars in thousands)</i>				
Nonaccrual loans	\$ 14,263	\$ 26,444	\$ 2,618	\$ 972	\$ 1,661
Loans past due 90 days or more and still accruing	28	297	14	41	
Total nonperforming loans	14,291	26,741	2,632	1,013	1,661
Other real estate owned	11,204	4,148	402		
Other vehicles owned	65	129	135	47	40
Total nonperforming assets	\$ 25,560	\$ 31,018	\$ 3,169	\$ 1,060	\$ 1,701
Interest income forgone on nonaccrual loans	\$ 568	\$ 576	\$ 161	\$ 53	\$ 39
Interest income recorded on a cash basis on nonaccrual loans	\$ 369	\$ 74	\$ 118	\$ 116	\$ 16
Nonperforming loans to total loans	4.30%	7.31%	0.75%	0.29%	0.52%
Nonperforming assets to total Assets	4.84%	6.78%	0.70%	0.22%	0.36%
Allowance for loan losses to nonperforming Loans	67%	27%	160%	387%	196%

Nonperforming loans at December 31, 2009 were \$14.3 million, a decrease of \$12.4 million from the \$26.7 million balance at December 31, 2008. Of the total nonperforming loans at December 31, 2009, eight loans had principal balances ranging from \$2.3 million to \$534 thousand. In total these loans amount to \$9.5 million representing 66% of the nonaccrual balance of \$14.3 million. Specific reserves of \$1.8 million were allocated to these loans. For all nonaccrual loans at December 31, 2009 specific reserves totaled \$2.6 million or 18% of total nonaccrual loans. Additionally, the nonaccrual balances at December 31, 2009 are net of \$965 thousand in partial charge-offs.

At December 31, 2009 and 2008, the Company's recorded investment in impaired loans totaled \$19.2 million and \$26.4 million, respectively. The specific allowance for loan losses related to impaired loans was \$4.3 million and \$3.1 million at December 31, 2009 and 2008, respectively. The average recorded investment in impaired loans was \$25.1 million, \$5.2 million, \$1.7 million for the years ended December 31, 2009, 2008 and 2007, respectively. In most cases, the Company uses the cash basis method of income recognition for impaired loans. For the years ended December 31, 2009, 2008 and 2007, the Company recognized \$369 thousand, \$74 thousand and \$118 thousand, respectively, of income on such loans. Interest foregone on impaired loans totaled \$568 thousand \$576 thousand and \$161 thousand for the years ended December 31, 2009, 2008 and 2007, respectively.

It is the policy of management to make additions to the allowance for loan losses so that it remains appropriate to absorb the inherent risk of loss in the portfolio. Management believes that the allowance at December 31, 2009 is appropriate. However, the determination of the amount of the allowance is judgmental and subject to economic conditions which cannot be predicted with certainty. Accordingly, the Company cannot predict whether charge-offs of loans in excess of the allowance may occur in future periods.

OREO represents real property taken by the Bank either through foreclosure or through a deed in lieu thereof from the borrower. Repossessed assets include vehicles and other commercial assets acquired under agreements with delinquent borrowers. Repossessed assets and OREO are carried at the lesser of cost or fair market value, less selling

costs. OREO holdings represented twenty-nine properties totaling \$11.2 million at December 31, 2009 and nineteen properties totaling \$4.1 million at December 31, 2008. Of the twenty-nine properties, four properties represent 82% of the balance or \$9.2 million of the \$11.2 million. Nonperforming assets as a percentage of total assets decreased to 4.84% at December 31, 2009 down from 6.78% at December 31, 2008.

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Investment Portfolio and Federal Funds Sold. Total investment securities increased \$49.6 million, or 129%, to \$88.0 million as of December 31, 2009, up from \$38.4 million as of December 31, 2008. There were no Federal funds sold at December 31, 2009 or 2008.

The growth in the investment portfolio was related to purchases of securities of U.S. government agencies, resulting in a significant increase in these securities as a percentage of total investment securities. The investment portfolio balances in U.S. Treasuries, U.S. Government agencies, corporate debt securities and municipal obligations comprised 1%, 86%, 0% and 13%, respectively, at December 31, 2009 versus 4%, 59%, 4% and 33%, respectively, at December 31, 2008.

The Company increased its level of agency securities primarily to support our growth in public agency deposits which require the pledging of investment securities for balances in excess of those covered by FDIC insurance. In addition, these investments provide a favorable spread over the Company's cost of interest-bearing liabilities. Funding for the increase in securities of U.S. government agencies was provided by an increase in our deposits and proceeds from the sale of Series A Preferred Stock.

The Company's investments in mortgage-backed securities of U.S. Government agencies provide interest income as well as cash flows for liquidity and reinvestment opportunities as these securities pay down. At December 31, 2009, total balances in these mortgage-backed securities were \$19.3 million up from \$12.4 million at December 31, 2008. Although these pass-through securities typically have final maturities of between ten and fifteen years, the pass-through nature of principal payments from the prepayment or refinance of loans underlying these securities is expected to significantly reduce their average life.

Obligations of states and political subdivisions (municipal securities) provide attractive tax equivalent yields for the Company. Since the majority of the interest earnings on these securities are not taxable for Federal purposes the investment in municipal securities results in a reduction in the effective tax rate of the Company.

The Company classifies its investment securities as available-for-sale or held-to-maturity. The Company transferred its municipal obligations to the available-for-sale category on December 31, 2009 as it no longer has the intention to hold these securities until maturity. Securities classified as available-for-sale may be sold to implement the Company's asset/liability management strategies and in response to changes in interest rates, prepayment rates and similar factors. The following tables summarize the values of the Company's investment securities held on the dates indicated:

Available-for-sale (fair value)	2009	December 31,	
		2008	2007
		<i>(dollars in thousands)</i>	
U.S. Treasuries	\$ 1,052	\$ 1,508	\$ 3,481
U.S. Government agencies	55,889	10,392	19,662
Corporate debt securities		1,550	3,923
U.S. Government agency mortgage-backed Securities	19,287	12,357	14,738
Municipal obligations	11,722		
Total	\$ 87,950	\$ 25,807	\$ 41,804

Held-to-maturity (amortized cost)	2009	December 31,	
		2008	2007
		<i>(dollars in thousands)</i>	
Municipal obligations	\$	\$ 12,567	\$ 13,488

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The following table summarizes the maturities of the Company's securities at their carrying value and their weighted average tax equivalent yields at December 31, 2009.

<i>(dollars in thousands)</i> Available-for-sale (Fair Value)	One Year or Less		After One Through Five Years		After Five Through Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
U.S. Treasuries	\$		%\$ 1,052	1.07%	\$		%\$		%\$ 1,052	1.07%
U.S. Government agencies			% 55,889	2.45%			%		% 55,889	2.45%
U.S. Government agency mortgage-backed securities	1,815	3.52%	2,539	3.90%	4,439	4.78%	10,494	3.94%	19,287	4.08%
Municipal obligations			% 3,725	5.19%	7,997	5.71%			% 11,722	5.55%
Total	\$ 1,815	3.52%	\$ 63,205	2.65%	\$ 12,436	5.39%	\$ 10,494	3.94%	\$ 87,950	3.19%

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Deposits. Total deposits were \$433.3 million as of December 31, 2009, an increase of \$61.8 million, or 17%, from the December 31, 2008 balance of \$371.5 million. The largest components of this increase were increases of \$33.5 million in interest-bearing transaction accounts (NOW), \$24.4 million in time deposits and \$5.0 million in money market deposits. The increase in NOW accounts is primarily related to a new interest bearing transaction account designed for local public agencies, which we have successfully marketed to several of the municipalities in our service area. Deposits related to this account increased by \$31.8 million from \$6.0 million at December 31, 2008 to \$37.8 million at December 31, 2009. These accounts pay rates comparable to those available on a money market fund offered by a typical brokerage firm. We are required to pledge investment securities as collateral against the uninsured portion of these deposits. The increase in time deposits is primary related to a promotional time deposit product we began offering in June, 2009. This product had an 18 month term and a 2% rate. Money market balances benefited from an on balance sheet corporate sweep product which we introduced during the first quarter of 2008. Deposits related to this product increased by \$4.3 million from \$9.0 million at December 31, 2008 to \$13.3 million at December 31, 2009.

As of December 31, 2009, primarily due to the change in mix of deposits, non-interest bearing demand deposits and interest checking deposits increased to 50.3% of total deposits versus 49.9% at December 31, 2008. Money market and savings deposits decreased to 21.4% of total deposits as of December 31, 2009 compared to 23.6% as of December 31, 2008. Time deposits increased to 28.3% of total deposits as of December 31, 2009 compared to 26.5% at December 31, 2008.

Deposits represent the Bank's primary source of funds. Deposits are primarily core deposits in that they are demand, savings and time deposits generated from local businesses and individuals. These sources are considered to be relatively stable, long-term relationships thereby enhancing steady growth of the deposit base without major fluctuations in overall deposit balances. The Company experiences, to a small degree, some seasonality with the slower growth period between November through April, and the higher growth period from May through October. In order to assist in meeting any funding demands, the Company maintains secured borrowing arrangements with the Federal Home Loan Bank and the Federal Reserve Bank of San Francisco. Included in time deposits at December 31, 2009 were \$5 million in CDARS reciprocal time deposits which, under regulatory guidelines, are classified as brokered deposits. The Company did not hold brokered deposits during the years ended December 31, 2008 or 2007.

The following chart sets forth the distribution of the Company's average daily deposits for the periods indicated.

	2009		2008		2007	
	Average Balance	Rate %	Average Balance <i>(dollars in thousands)</i>	Rate %	Average Balance	Rate %
Non-interest-bearing deposits	\$ 108,059		\$ 111,999		\$ 114,831	
Interest-bearing deposits:						
Interest bearing demand deposits	98,394	0.68%	73,338	0.75%	77,254	1.73%
Money market accounts	41,844	0.83%	37,626	0.83%	39,431	0.83%
Savings	50,286	0.18%	48,573	0.33%	50,448	0.49%
Time deposits	105,313	1.96%	110,743	3.16%	121,808	4.35%
Total interest bearing deposits	295,837	1.07%	270,280	1.67%	288,941	2.50%
Total deposits	\$ 403,896	0.78%	\$ 382,279	1.18%	\$ 403,772	1.79%

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The Company's time deposits of \$100,000 or more had the following schedule of maturities at December 31, 2009:

<i>(dollars in thousands)</i>	Amount
Remaining Maturity:	
Three months or less	\$ 13,031
Over three months to six months	7,729
Over six months to 12 months	9,881
Over 12 months	24,362
 Total	 \$ 55,003

Time deposits of \$100,000 or more are generally from the Company's local business and individual customer base. The potential impact on the Company's liquidity from the withdrawal of these deposits is discussed at the Company's asset and liability management committee meetings, and is considered to be minimal.

Short-term borrowing arrangements. The Company has a secured short-term borrowing arrangement with one of its correspondent banks in the amount of \$5,000,000. No borrowings were outstanding under this arrangement at December 31, 2009 or December 31, 2008. In addition, the Company has the ability to secure advances through the FRB discount window. These advances also must be collateralized.

The Company is a member of the FHLB and can borrow up to \$82,056,000 from the FHLB secured by commercial and residential mortgage loans with carrying values totaling \$231,492,000. The Company is required to hold FHLB stock as a condition of membership. At December 31, 2009, the Company held \$1,933,000 of FHLB stock which is recorded as a component of other assets. At this level of stock holdings the Company can borrow up to \$41,132,000. Total borrowings at December 31, 2009 from the FHLB were \$40,000,000 consisting of both short-term and long-term FHLB advances. To borrow the \$82,056,000 in available credit the Company would need to purchase \$1,924,000 in additional FHLB stock.

Short-term borrowings at December 31, 2009 consisted of a \$20,000,000 FHLB advance at 0.47% with a maturity date of January 19, 2010. At December 31, 2008 short-term borrowings consisted of a one day \$34,000,000 FHLB advance with an interest rate of 0.05%.

The average balance in short-term borrowings during the years ended December 31, 2009 and 2008 were \$24.3 million and \$11.9 million, respectively. The average rate paid on these borrowings was 0.33% during 2009 and 1.70% during 2008. The maximum amount of short-term borrowings outstanding at any month-end during 2009 and 2008 was \$33.8 million and \$34.0 million, respectively.

Long-term borrowing arrangements. Long-term borrowings at December 31, 2009 consisted of two \$10,000,000 FHLB advances. The first advance matures on November 23, 2011 and bears interest at 1.00%. The second advance matures on November 23, 2012 and bears interest at 1.60%. Interest rates on both advances are fixed until maturity.

Capital Resources

Shareholders' equity as of December 31, 2009 increased to \$38.2 million up from \$35.4 million as of December 31, 2008. This increase is related to the issuance of \$11.9 million in Preferred Stock, Series A as described in the following paragraph, partially offset by our 2009 net loss and \$628 thousand of dividends on the Preferred Stock.

On January 30, 2009, under the Capital Purchase Program, the Company entered into a Letter Agreement (the "Purchase Agreement") with the United States Department of the Treasury, pursuant to which the Company issued and sold (i) 11,949 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Preferred Shares") and (ii) a ten-year warrant to purchase up to 237,712 shares of the Company's common stock, no par value at an exercise price, subject to anti-dilution adjustments, of \$7.54 per share, for an aggregate purchase price of \$11,949,000 in cash. The Series A Preferred Stock and the Warrant were issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. The Purchase Agreement contains provisions that restrict the payment of dividends on Plumas Bancorp common stock and restrict the Company's ability to repurchase Plumas Bancorp common stock.

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Eight million of the twelve million in proceeds from the sale of the Series A Preferred Stock was injected into Plumas Bank providing addition capital for the bank to support growth in loans and investment securities and strengthen its capital ratios. The remainder provides funds for holding company activities and general corporate purposes.

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). The Board will periodically, but on no regular schedule, review the appropriateness of a cash dividend payment.

No common cash dividends were paid in 2009. On April 24, 2009, the Company announced that it would be suspending its semi-annual common stock cash dividend for the first half of 2009. During 2008 the Company paid two semi-annual common cash dividends to holders of common stock, the first was 16 cents paid on May 16, 2008 and on November 21, 2008 we paid a second cash dividend of 8 cents per share. The Company's Board of Directors will continue to evaluate the payment of a semi-annual common stock cash dividend in future quarters, but does not anticipate paying a cash dividend in 2010. The Company is subject to various restrictions on the payment of dividends. See Note 11 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.

Capital Standards. The decrease in the Company's regulatory capital during 2009 is attributed to an increase in that portion of the Company's deferred tax asset that under regulatory capital guidelines is required to be deducted from capital in the computation of regulatory capital ratios, mostly offset by the increase in shareholders' equity described above. In addition, the Company's leverage capital ratios declined due to an increase in its quarterly average assets from \$449 million during the fourth quarter of 2008 to \$523 million during the current fourth quarter.

The Company uses a variety of measures to evaluate its capital adequacy, with risk-based capital ratios calculated separately for the Company and the Bank. Management reviews these capital measurements on a monthly basis and takes appropriate action to ensure that they are within established internal and external guidelines. The Company's current capital position exceeds minimum thresholds established by industry regulators, and by current regulatory definitions the Bank is well capitalized, the highest rating of the categories defined under Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991. The FDIC has promulgated risk-based capital guidelines for all state non-member banks such as the Bank. These guidelines establish a risk-adjusted ratio relating capital to different categories of assets and off-balance sheet exposures. There are two categories of capital under the guidelines: Tier 1 capital includes common stockholders' equity, and qualifying trust-preferred securities (including notes payable to unconsolidated special purpose entities that issue trust-preferred securities), less goodwill and certain other deductions, notably the unrealized net gains or losses (after tax adjustments) on available for sale investment securities carried at fair market value; Tier 2 capital can include qualifying subordinated debt and the allowance for loan and lease losses, subject to certain limitations. The Series A Preferred Stock qualifies as Tier 1 capital for the Company.

As noted previously, the Company's junior subordinated debentures represent borrowings from its unconsolidated subsidiaries that have issued an aggregate \$10 million in trust-preferred securities. These trust-preferred securities currently qualify for inclusion as Tier 1 capital for regulatory purposes as they do not exceed 25% of total Tier 1 capital, but are classified as long-term debt in accordance with GAAP. On March 1, 2005, the Federal Reserve Board adopted a final rule that allows the continued inclusion of trust-preferred securities (and/or related subordinated debentures) in the Tier I capital of bank holding companies. However, under the final rule, after a five-year transition period goodwill must be deducted from Tier I capital prior to calculating the 25% limitation. Generally, the amount of junior subordinated debentures in excess of the 25% Tier 1 limitation is included in Tier 2 capital. On March 23, 2009 the requirement to deduct goodwill was delayed until March 31, 2011.

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The following tables present the capital ratios for the Company and the Bank compared to the standards for bank holding companies and the regulatory minimum requirements for depository institutions as of December 31, 2009 and 2008 (amounts in thousands except percentage amounts).

	December 31, 2009		December 31, 2008	
	Amount	Ratio	Amount	Ratio
Tier 1 Leverage Ratio				
Plumas Bancorp and Subsidiary	\$ 40,564	7.9%	\$ 43,885	9.8%
Minimum regulatory requirement	20,652	4.0%	17,907	4.0%
Plumas Bank	38,172	7.4%	43,372	9.7%
Minimum requirement for Well-Capitalized institution under the prompt corrective action plan	25,848	5.0%	22,365	5.0%
Minimum regulatory requirement	20,678	4.0%	17,892	4.0%
Tier 1 Risk-Based Capital Ratio				
Plumas Bancorp and Subsidiary	40,564	10.4%	43,885	11.0%
Minimum regulatory requirement	15,641	4.0%	16,021	4.0%
Plumas Bank	38,172	9.8%	43,372	10.8%
Minimum requirement for Well-Capitalized institution under the prompt corrective action plan	23,433	6.0%	23,996	6.0%
Minimum regulatory requirement	15,622	4.0%	15,997	4.0%
Total Risk-Based Capital Ratio				
Plumas Bancorp and Subsidiary	45,512	11.6%	48,919	12.2%
Minimum regulatory requirement	31,281	8.0%	32,042	8.0%
Plumas Bank	43,113	11.0%	48,399	12.1%
Minimum requirement for Well-Capitalized institution under the prompt corrective action plan	39,056	10.0%	39,994	10.0%
Minimum regulatory requirement	31,244	8.0%	31,995	8.0%

The current and projected capital positions of the Company and the Bank and the impact of capital plans and long-term strategies are reviewed regularly by management. The Company policy is to maintain the Bank's ratios above the prescribed well-capitalized leverage, Tier 1 risk-based and total risk-based capital ratios of 5%, 6% and 10%, respectively, at all times.

Off-Balance Sheet Arrangements

Loan Commitments. In the normal course of business, there are various commitments outstanding to extend credits that are not reflected in the financial statements. Commitments to extend credit and letters of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Annual review of commercial credit lines, letters of credit and ongoing monitoring of outstanding balances reduces the risk of loss associated with these commitments. As of December 31, 2009, the Company had \$67.3 million in unfunded loan commitments and \$304 thousand in letters of credit. This compares to \$78.8 million in unfunded commitments and \$534 thousand in letters of credit at December 31, 2008. Of the \$67.3 million in unfunded loan commitments, \$30.3 million and \$37.0 million represented commitments to commercial and consumer customers, respectively. Of the total unfunded commitments at December 31, 2009, \$34.3 million were secured by real estate, of which \$7.6 million was secured by commercial real estate and \$26.7 million was secured by residential real estate in the form of equity lines of credit. The commercial loan commitments not secured by real estate primarily represent business lines of credit, while the consumer loan commitments not secured by real estate primarily represent revolving credit card lines. Since, some of the commitments are expected to expire without being drawn upon; the total commitment amounts do not necessarily represent future cash requirements.

Operating Leases. The Company leases three depository branches as well as two lending offices and a non branch automated teller machine location. Total rental expenses under all operating leases, including premises, totaled \$317,000 \$347,000 and \$209,000, in 2009, 2008 and 2007 respectively. The expiration dates of the leases vary, with the first such lease expiring during 2010 and the last such lease expiring during 2018.

Table of Contents**Liquidity**

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

The Company is a member of the FHLB and can borrow up to \$82,056,000 from the FHLB secured by commercial and residential mortgage loans with carrying values totaling \$231,492,000. The Company is required to hold FHLB stock as a condition of membership. At December 31, 2009, the Company held \$1,933,000 of FHLB stock which is recorded as a component of other assets. At this level of stock holdings the Company can borrow up to \$41,132,000. Total borrowings at December 31, 2009 from the FHLB were \$40,000,000 consisting of both short-term and long-term FHLB advances. To borrow the \$82,056,000 in available credit the Company would need to purchase \$1,924,000 in additional FHLB stock. At December 31, 2008 FHLB borrowings consisted of a one day \$34,000,000 FHLB advance.

The Company has a secured short-term borrowing arrangement with one of its correspondent banks in the amount of \$5,000,000. No borrowings were outstanding under this arrangement at December 31, 2009 or 2008. In addition, the Company has the ability to secure advances through the FRB discount window. These advances also must be collateralized.

Customer deposits are the Company's primary source of funds. Total deposits were \$433.3 million as of December 31, 2009, an increase of \$61.8 million, or 17%, from the December 31, 2008 balance of \$371.5 million. Deposits are held in various forms with varying maturities. The Company's securities portfolio, Federal funds sold, Federal Home Loan Bank advances, and cash and due from banks serve as the primary sources of liquidity, providing adequate funding for loans during periods of high loan demand. During periods of decreased lending, funds obtained from the maturing or sale of investments, loan payments, and new deposits are invested in short-term earning assets, such as cash held at the FRB, Federal funds sold and investment securities, to serve as a source of funding for future loan growth. Management believes that the Company's available sources of funds, including borrowings, will provide adequate liquidity for its operations in the foreseeable future.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company we are not required to provide the information required by this item.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following consolidated financial statements of Plumas Bancorp and subsidiary, and report of the independent registered public accounting firm are included in the Annual Report of Plumas Bancorp to its shareholders for the years ended December 31, 2009, 2008 and 2007.

	Page
<u>Report of Independent Registered Public Accounting Firm</u>	F-1
<u>Consolidated Balance Sheet as of December 31, 2009 and 2008</u>	F-2
<u>Consolidated Statement of Income for the years ended December 31, 2009, 2008 and 2007</u>	F-3
<u>Consolidated Statement of Changes in Shareholders' Equity for the years ended December 31, 2009, 2008 and 2007</u>	F-5
<u>Consolidated Statement of Cash Flows for the years ended December 31, 2009, 2008 and 2007</u>	F-7
<u>Notes to Consolidated Financial Statements</u>	F-10

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Shareholders and Board of Directors

Plumas Bancorp and Subsidiary

We have audited the accompanying consolidated balance sheet of Plumas Bancorp and subsidiary (the Company) as of December 31, 2009 and 2008 and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2009. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Plumas Bancorp and subsidiary as of December 31, 2009 and 2008 and the consolidated results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America.

We were not required or engaged to examine the effectiveness of Plumas Bancorp's internal control over financial reporting as of December 31, 2009, and, accordingly, we do not express an opinion thereon.

/s/ Perry-Smith LLP

Sacramento, California

March 19, 2010

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**PLUMAS BANCORP AND SUBSIDIARY
CONSOLIDATED BALANCE SHEET
December 31, 2009 and 2008**

	2009	2008
ASSETS		
Cash and cash equivalents	\$ 59,493,000	\$ 18,791,000
Investment securities	87,950,000	38,374,000
Loans, less allowance for loan losses of \$9,568,000 in 2009 and \$7,224,000 in 2008	323,408,000	359,072,000
Premises and equipment, net	14,544,000	15,764,000
Intangible assets, net	648,000	821,000
Bank owned life insurance	10,111,000	9,766,000
Real estate and vehicles acquired through foreclosure	11,269,000	4,277,000
Accrued interest receivable and other assets	20,694,000	10,310,000
Total assets	\$ 528,117,000	\$ 457,175,000
 LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits:		
Non-interest bearing	\$ 111,958,000	\$ 112,783,000
Interest bearing	321,297,000	258,710,000
Total deposits	433,255,000	371,493,000
Short-term borrowings	20,000,000	34,000,000
Long-term debt	20,000,000	
Accrued interest payable and other liabilities	6,321,000	5,935,000
Junior subordinated deferrable interest debentures	10,310,000	10,310,000
Total liabilities	489,886,000	421,738,000
Commitments and contingencies (Note 10)		
 Shareholders equity:		
Serial preferred stock no par value; 10,000,000 shares authorized; 11,949 issued and outstanding at December 31, 2009	11,595,000	
Common stock no par value; 22,500,000 shares authorized; issued and outstanding 4,776,339 shares in 2009 and 4,775,339 shares in 2008	5,970,000	5,302,000
Retained earnings	20,044,000	29,818,000
Accumulated other comprehensive income	622,000	317,000

Total shareholders' equity	38,231,000	35,437,000
Total liabilities and shareholders' equity	\$ 528,117,000	\$ 457,175,000

The accompanying notes are an integral part of these consolidated financial statements.

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**PLUMAS BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENT OF INCOME
For the Years Ended December 31, 2009, 2008 and 2007**

	2009	2008	2007
Interest income:			
Interest and fees on loans	\$ 20,658,000	\$ 23,550,000	\$ 27,709,000
Interest on investment securities:			
Taxable	1,708,000	1,398,000	1,900,000
Exempt from Federal income taxes	455,000	489,000	504,000
Interest on Federal funds sold	15,000	3,000	171,000
Total interest income	22,836,000	25,440,000	30,284,000
Interest expense:			
Interest on deposits	3,169,000	4,522,000	7,211,000
Interest on short-term borrowings	80,000	202,000	467,000
Interest on junior subordinated deferrable interest debentures	371,000	623,000	835,000
Other	35,000	17,000	23,000
Total interest expense	3,655,000	5,364,000	8,536,000
Net interest income before provision for loan losses	19,181,000	20,076,000	21,748,000
Provision for loan losses	14,500,000	4,600,000	800,000
Net interest income after provision for loan losses	4,681,000	15,476,000	20,948,000
Non-interest income:			
Service charges	3,796,000	3,951,000	3,806,000
Gain on sale of loans	593,000	111,000	47,000
Impairment loss on investment security		(415,000)	
Earnings on Bank owned life insurance policies	434,000	421,000	415,000
Other	929,000	1,023,000	1,180,000
Total non-interest income	5,752,000	5,091,000	5,448,000

(Continued)

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**PLUMAS BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENT OF INCOME**

(Continued)

For the Years Ended December 31, 2009, 2008 and 2007

	2009	2008	2007
Non-interest expenses:			
Salaries and employee benefits	\$ 11,054,000	\$ 10,884,000	\$ 11,200,000
Occupancy and equipment	3,759,000	3,838,000	3,552,000
Provision for losses on other real estate	4,800,000	618,000	
Other	6,741,000	5,135,000	4,919,000
Total non-interest expenses	26,354,000	20,475,000	19,671,000
Income (loss) before income taxes	(15,921,000)	92,000	6,725,000
Provision (benefit) for income taxes	(6,775,000)	(212,000)	2,502,000
Net income (loss)	\$ (9,146,000)	\$ 304,000	\$ 4,223,000
Basic earnings (loss) per share	\$ (2.05)	\$ 0.06	\$ 0.85
Diluted earnings (loss) per share	\$ (2.05)	\$ 0.06	\$ 0.84
Common dividends per share	\$	\$ 0.24	\$ 0.30

**The accompanying notes are an integral
part of these consolidated financial statements.**

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PLUMAS BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY
For the Years Ended December 31, 2009, 2008 and 2007

	Preferred Stock Shares	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive (Loss) Income (Net of Taxes)	Total Shareholders Equity	Total Comprehensive Income
Balance, January 1, 2007		5,023,205	\$ 4,828,000	\$ 31,716,000	\$ (692,000)	\$ 35,852,000	
Comprehensive income):							
Net income				4,223,000		4,223,000	\$ 4,223,000
Other comprehensive income, net of tax:							
Net change in unrealized losses on available-for-sale investment securities					585,000	585,000	585,000
Total comprehensive income							\$ 4,808,000
Cash dividends \$0.30 per share				(1,491,000)		(1,491,000)	
Retirement of common stock in connection with the exercise of stock options		(4,630)	(70,000)			(70,000)	
Stock options exercised and related tax benefit		19,292	152,000			152,000	
Stock-based compensation expense			288,000			288,000	
Repurchase and retirement of common stock		(168,737)	(156,000)	(2,244,000)		(2,400,000)	

Balance, December 31, 2007	4,869,130	5,042,000	32,204,000	(107,000)	37,139,000	
Cumulative effect of change in accounting principle, adoption of EITF 06-4			(420,000)		(420,000)	
Comprehensive income:						
Net income			304,000		304,000	\$ 304,000
Other comprehensive income, net of tax:						
Net change in unrealized (losses)/gains on available-for-sale investment securities				424,000	424,000	424,000
Total comprehensive income						\$ 728,000
Cash dividends \$0.24 per share			(1,153,000)		(1,153,000)	
Stock options exercised and related tax benefit	12,476	68,000			68,000	
Stock-based compensation expense		292,000			292,000	
Repurchase and retirement of common stock	(106,267)	(100,000)	(1,117,000)		(1,217,000)	
Balance, December 31, 2008	4,775,339	\$ 5,302,000	\$ 29,818,000	\$ 317,000	\$ 35,437,000	

(Continued)

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PLUMAS BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

(Continued)

For the Years Ended December 31, 2009, 2008 and 2007

	Preferred Stock		Common Stock		Retained Earnings	Accumulated	Total Shareholder Equity	Total Comprehensive Income
	Shares	Amount	Shares	Amount		Other Comprehensive Income (Net of Taxes)		
Balance, December 31, 2008			4,775,339	\$ 5,302,000	\$ 29,818,000	\$ 317,000	\$ 35,437,000	
Comprehensive loss:								
Net loss					(9,146,000)		(9,146,000)	\$(9,146,000)
Other comprehensive loss, net of tax:								
Unrealized gains on securities transferred from held-to-maturity to available-for-sale						197,000	197,000	197,000
Net change in unrealized gains on available-for-sale investment securities						108,000	108,000	108,000
Total comprehensive loss								\$(8,841,000)
Preferred stock issued	11,949	\$ 11,516,000					11,516,000	
Preferred stock discount accretion		79,000					79,000	
Stock warrants issued				407,000			407,000	
Preferred stock dividends & accretion					(628,000)		(628,000)	

Stock options exercised and related tax benefit	1,000	5,000	5,000
Stock-based compensation expense		256,000	256,000

Balance, December 31, 2009	11,949	\$ 11,595,000	4,776,339	\$ 5,970,000	\$ 20,044,000	\$ 622,000	\$ 38,231,000
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The accompanying notes are an integral part of these consolidated financial statements.

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**PLUMAS BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2009, 2008 and 2007**

2009

2008

2007